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MFA Report on Organization, Status, and Regulatory Framework

EGYPT FINANCIAL SERVICES PROJECT
TECHNICAL REPORT #37

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ACRONYMS

| | |
|---------|--|
| ABS | Asset-Backed Securities |
| AI | Appraisal Institute |
| AMCHAM | American Chamber of Commerce in Egypt |
| ALC | Arab Legal Consultants |
| AOJS II | Administration of Justice Support II |
| BDA | Bond Dealers Association |
| BOD | Board of Directors |
| CBE | Central Bank of Egypt |
| CIDA | Canadian International Development Agency |
| CAPMAS | Central Agency for Public Mobilization and Statistics |
| CASE | Cairo and Alexandria Stock Exchanges |
| CBE | Central Bank of Egypt |
| CMA | Capital Market Authority |
| COTS | Commercial Off-the-Shelf |
| COP | Chief of Party |
| CRA | Commercial Registry Authority |
| CORS | Continually Operating Reference Stations |
| DCA | Development Credit Authority |
| DO | Egyptian Survey Authority District Office |
| DVP | Delivery versus Payment |
| DTGS | Direct Transfer Gross Settlement System |
| EAA | Egyptian Appraisers Association |
| EALB | Egyptian Arab Land Bank |
| EAR | Egyptian Association of Realtors |
| EAREA | Egyptian Association of Real Estate Appraisers |
| EBA | Egyptian Bankers Association |
| EBI | Egyptian Banking Institute |
| EISA | Egyptian Insurance Supervisory Authority |
| ECIM | Egyptian Cadastral Information Management (Finnish-funded project) |
| ECMA | Egyptian Capital Market Association |
| EDO | Egyptian Survey Authority District Office |
| EFS | Egypt Financial Services |
| ELF | Egyptian Finance Liquidity Facility |
| EHFC | Egyptian Housing Finance Company |
| EIMA | Egyptian Investment Management Association |
| EISA | Egyptian Insurance Supervisory Authority |
| EJA | Egyptian Judges Association |
| ELA | Egyptian Lawyers Association |
| EMA | Egyptian Mortgage Association |
| EMBA | Egyptian Mortgage Brokers Association |
| EPO | Egyptian Survey Authority Provincial Office |
| ESA | Egyptian Survey Authority |
| EREA | Egyptian Real Estate Association |
| ERESA | Egyptian Real Estate Surveyors Association |
| ESA | Egyptian Survey Authority |
| ESOP | Employment Stock Ownership Plan |
| ESRI | Environment Systems Research Institute |
| EU | European Union |
| FinBi | Finance and Banking Consultants International |
| FTC | Federal Trade Commission |

| | |
|----------|---|
| FSVC | Financial Services Volunteer Corps |
| GAFI | General Authority for Free Zones and Investment |
| GIS | Geographic Information System |
| GOE | Government of Egypt |
| GSF | Guarantee and Subsidy for Real Estate Activities Fund |
| H&A | Hassouna and Abou Ali Law Firm |
| IFC | International Finance Corporation |
| IFS | International Federation of Surveyors (Egypt Chapter) |
| IHF | International Housing Finance |
| ILS | International Land Systems, Inc. |
| IPF | Investor Protection Fund |
| KRA | Key Results Area |
| LADIS | Legislation and Development Information Systems |
| MBA | Mortgage Bankers Association |
| MCDR | Misr for Clearing, Depository, and Registry |
| MFA | Mortgage Finance Authority |
| MFC | Mortgage Finance Company |
| MLS | Multiple-listing Service |
| MSAD | Ministry of State for Administrative Development |
| MOF | Ministry of Finance |
| MOH | Ministry of Housing |
| MOJ | Ministry of Justice |
| MOI | Ministry of Investment |
| MOU | Memorandum of Understanding |
| NAR | National Association of Realtors |
| NASD | National Association of Securities Dealers |
| NCCIC | New Cairo Community Information Center |
| NCJS | National Center for Judicial Studies |
| NIB | National Investment Bank |
| NFI | New Financial Instrument |
| NUCA | New Urban Community Authority for Sixth of October |
| OST | Overseas Study Tour |
| PEA | Project Execution Agreement |
| PO | Provincial Office (of the Egyptian Survey Authority) |
| PIN | Parcel Identification Number |
| PMU | Project Management Unit |
| QPR | Quarterly Progress Report |
| QSIT | Quality Standards Information Technology |
| REPD | Real Estate Publicity Department |
| RETD | Real Estate Tax Department |
| RFP | Request for Proposal |
| RFQ | Request for Quotation |
| RO | Registry Office |
| SEC | Securities and Exchange Commission |
| SII | Securities and Investment Institute |
| ST | Short-term |
| TDL | Training Development Laboratory |
| UCD | Universal Cadastral Database |
| UNCITRAL | United Nations Commission on International Trade Law |
| USAID | United States Agency for International Development |
| WB | World Bank |
| YEBA | Young Egyptian Bankers Association |
| Z&K | Zarrouk, Khaled & Co. |

Executive Summary

The purpose of this report is to address three subjects pertaining to Mortgage Finance Authority (MFA) and the regulatory environment. These are Items 2, 3, and 4 in the scope of work for this project, and this report is one of two deliverables under that scope of work. Briefly, the subjects are: A) review (and possible revision) of proposed job descriptions, focusing on the Industry Affairs Department, B) an assessment of the extent to which MFA is fulfilling its mandate, and C) a comparison of the Law and Regulations to assess the adequacy of the regulatory framework.

The first two purposes are closely related, with the first (A) growing out of the second (B). MFA is currently not fulfilling its mandate, because it is still in the start-up phase. Some progress is being made, however, with a new chairman and some senior staff recently being hired. At the present time there are few mortgage lending companies to regulate, and real estate loan volume is low. Significant technical assistance is being offered by this project, EFS-USAID. As a continuation of Item B this report makes certain recommendations pertaining to organization, focusing on emphasis of MFA's supervisory role, with less emphasis on industry and consumer liaisons. Item A job description revisions reflect these shifts with specific recommendations. Due to recommendations for organizational change in Item B, Item A was somewhat expanded.

Item C is the most extensive section, with the purpose of assessing the adequacy of regulatory structure to locate significant gaps. The essential conclusion is that the regulatory framework needs significant expansion and further development in a number of areas, and recommendations for specifics are made. Areas addressed include MFA cooperation with the Central Bank of Egypt, capital adequacy, asset quality (the most extensive section), licensing, management and corporate governance, financial performance, consumer protection, related entities, anti-money-laundering and combating financing of terrorism, and supervisory actions. Some additions or changes to the Law may be required to support regulatory additions. Drafting of model regulations is beyond the scope of this report. Recommendations have been included, however, for some key principles and guidelines that should be considered in drafting of regulations. A schedule proposing priorities and an action plan completes the section.

In Appendix A, existing Regulations are compared with the Real Estate Finance Law for consistency and adequacy. Appendix C gives web-sites of regulators and others, containing information useful in designing and drafting regulations.

Introduction

A strong and stable residential mortgage lending market can produce a number of economic benefits, as well as some less tangible. Facilitating housing sales and construction fosters economic growth, including job creation. Citizens are more mobile geographically and economically and have greater choices in where to live. Housing becomes more accessible and exists in greater variety, fulfilling a wider range of consumer needs. Homeownership can provide families with stability, security, and other benefits. Programs for low- and moderate-income persons can assist entry into the housing market.

Financial intermediaries such as banks occupy an important place in the economy, fostering growth and stability, and providing liquidity for wealth. As a result, banks are much more highly regulated than other businesses. Real estate finance companies (mortgage lenders) authorized under the Egyptian Law do not take deposits nor perform payment operations, two important bank risk areas. But such companies still need to be regulated for safety and soundness. A mortgage lender failure is a shock to the financial system and causes disruption in the flow of mortgage funds. In addition, such failure can put at risk equity values and ownership interests of borrowers. A troubled mortgage lender may for a variety of reasons engage in unfair practices that are a detriment to healthy institutions or customers or the market overall.

The Egyptian Mortgage Finance Authority (MFA) was formed by the Real Estate Finance Law to regulate the mortgage lending industry. Its work is just starting, and its organization is just developing. Nevertheless, it must become effective quickly in order to facilitate development of the overall mortgage market in a safe and sound manner. The mortgage market faces a number of obstacles and issues, including property registration, chain of title, contract enforcement, foreclosure, possessory rights, and public education. Though resolving these is outside the scope of this report, many are pre-conditions for effective implementation of many recommendations herein.

This purpose of this report is to assess MFA organization, effectiveness, and regulatory framework at the present time and make recommendations for improvement, according to a specific Scope of Work agreed among Egyptian Financial Services project of the United States Agency for International Development (USAID), and MFA. Findings in this report are based on review of the existing Law and Regulations, a report on MFA organization (including job descriptions), other draft reports, and interviews with key persons in the real estate and mortgage industry. Recommendations were based on "best practices" from various sources, including web-sites of U.S. and international regulators and other organizations and the writer's professional experience. Most of these regulators supervise banks or similar depository institutions, while MFA supervises non-depository mortgage lenders. Nevertheless, most regulatory goals of safety and soundness and risk management remain the same.

The Egyptian real estate finance industry is just beginning, and its regulatory standards are developing also. Some flexibility will be warranted. At the same time, consistency is important for establishing lender and consumer confidence. Recommendations in this report should be a good first step in the areas it addresses. More importantly for the future, MFA will need to develop its own sense and systems for identifying, reviewing, evaluating, and resolving new issues as they emerge.

Background Research

Key persons interviewed, who are involved in the Egyptian mortgage finance industry, are listed in Appendix B.

Key documents reviewed include:

Real Estate Finance Law – 148/2001 (24 June 2001) (“Law”)

Executive Statutes of the Real Estate Finance Law (9 Dec 2001)
 (“Regulations”)

Amendments to Executive Statute – Prime Minister’s Decree No. 45/2005

Institutional Development of the Mortgage Finance Authority – Ira Peppercorn
(report; 22 April 2005) (“Peppercorn report”)

In addition, web-sites for a number of important financial institution regulatory authorities and other related organizations were reviewed. These web-sites can provide important guidelines for regulatory “best practices” especially for those drafting revisions to existing Law and Regulations. They are listed in Appendix C.

This research was not exhaustive but was important to find useful policies, documents, laws, regulations, and other background.

Acknowledgments

The writer of this report relied on the critical help of a number of persons. Most industry personnel, whose insights were of extreme importance to this report, are listed in Appendix C. In addition, Mr. Kevin O’Brien, Senior Real Estate Advisor, Task One, was of great help, as were many persons within the EFS project, especially Ms. Shamsnoor Abdul Aziz, Senior Legal Advisor, Ms. Amal Ezz El-Din, Senior Financial Advisor, Ms. Manal F. Shalaby, MBA, Senior Financial Advisor, and Ms. Lamia A. El-Zufzafy, Organizational Specialist.

I. Industry Affairs Organization at MFA

Item 2 in Scope of Work

Review the Industry Affairs functions and job descriptions proposed for the MFA in the Institutional Development Report (at both the top and second levels), in terms of the MFA mandate as it concerns regulations and supervisory functions. Possible adjustments could be proposed.

A few background remarks might clarify and provide context for review and recommendations within Industry Affairs.

Table of organization

Peppercorn report recommendations. The equivalency of the managers below the Chief Operating Officer (Internal Management, Industry Affairs, Research, Policy, and Analysis, and Consumer Affairs) seems to indicate similar importance, but this is somewhat misleading. Industry Affairs, the primary inspection, monitoring, and enforcement division, will have the most responsibility, the most work, and require the most resources. Other departments/divisions will mostly provide support to Industry Affairs. The job descriptions and other discussion indicate that these support departments could easily develop into large bureaucracies requiring more significant resources than necessary.

The organization of the Consumer Affairs department presents several problems. First, this department should not be a promoter or advocate of mortgage financing, as this could result in a conflict of interest or at least of efforts. This job should be up to the industry and to some extent the government. Consumer liaisons should be limited to educating and providing information to the public about mortgage lending and other industry products. This should be done in conjunction with the industry and any relevant ministry, perhaps by an external council or committee whose members are drawn from such stakeholder entities. This view does allow the recognition of the necessity of some outreach initiatives by the MFA alone or in a leadership role. The Ombudsman is a worthy and necessary function and can report either to the Deputy Chairman/COO as proposed, or to the Chairman.

The Disclosure Standards and Guidelines function should be moved to Legislation and Regulation, since it is primarily a regulatory function. Consumers should of course be polled and consulted in this area as products are developed and tested. Enforcement of these standards should be an integral part of the lender supervision function within Industry Affairs.

Discussion and Recommendations - Job Descriptions within Industry Affairs. Comments, discussion, and references not to be included in job description text are enclosed in square brackets (“[]”).

General comment. Text reviewed, especially the job descriptions, contained various grammar, syntax, and typographical errors. Mostly, however, the meaning was clear enough to a reader familiar with the concepts, though it might affect translation.

Within each job description, the first sub-heading “Job Descriptions” is considered redundant with the overall title and not entirely accurate. It has been revised for purposes herein to “Job Responsibilities”, with the second sub-heading of each Job Description retaining the title “Qualifications.”

Director of Industry Affairs. As rightly noted in the Institutional Development Report by Ira Peppercorn, this position is key in the organization and requires both a strategic grasp and operational and technical expertise. But the second sentence reads, “Its function is to lead the MFA to establishing a solid base with the key mortgage industry players and in tapping their expertise to find action oriented solutions.” Item three of the job description states that the office should “develop an agenda to best meet [MFA stakeholders’] business needs.” First, the term “key mortgage industry players” is too informal and unspecific, as is the term “solid base.” Secondly, while communication lines with the industry are necessary and while collaboration with the industry is important in facing systemic challenges and changes, the MFA’s primary mission is regulatory and can be adversarial.

Recommendations. Replace second sentence, and make deletions and reordering of job responsibilities as follows:

Job Description Director of Industry Affairs

This role requires a senior executive with deep industry solutions development experience in the financial services, housing or mortgage industries as well as an ability to manage within a governmental structure. [no change; second sentence delete and replace with:] Its purpose is to lead the MFA in establishing a sound and comprehensive mortgage lender regulatory function to include licensing, inspections, monitoring, and development of laws and regulations to facilitate a safe and sound housing finance industry and market.

This role will also require a great deal of operational, technical, and management experience, as the incumbent will have responsibility for developing a significant department of a new regulatory agency [minor changes for clarity].

Job Responsibilities [revised this title, so as not to be redundant with section title]
[revised and put into order of importance, roughly]

Organize, develop, staff, and manage a department with responsibilities for mortgage lender licensing, and monitoring and enforcement, and licensing of lending support professionals, including appraisers, real estate brokers, and loan brokers.

Provide timely support for on-going legislative and regulatory priorities of the MFA, and recommend new programs and initiatives the MFA should undertake

Develop relationships with key MFA stakeholders to develop an agenda for resolving obstacles to an effective mortgage market

Cooperate with industry groups to find action-oriented solutions to common challenges

Actively communicate with counterparts within the government and in similar regulatory organizations in Egypt and abroad

Structure an organization that can be responsive to the market, yet sensitive to consumers [not sure what this is trying to do; some conflicts possible]

Qualifications [changes only shown; otherwise original items remain unchanged]

[Item 1] Advanced degree (master's level or above) in business (especially finance and/or real estate), law or a related field

[Item 2] Strong background in finance, real estate, law, banking, or a related discipline

[Item 6] [Delete – Executive level contacts in mortgage and housing related fields; such contacts can be useful at times, but if relied upon can result in patronage, conflicts of interest and loss of objectivity]

[Item 12] [Delete – Outstanding community relations skills; this director should not be that public a figure, and though his work will be with the industry, it generally should not be with the general public]

Manager of Licensing. This is a key role, especially in the initial stages of industry development. It is easier and more effective to prevent troublesome persons from entering the market than removing them after their damage has been done. As written the job description seems to focus on licensing of support positions, such as appraisers and real estate brokers. Emphasis should be on start-up of new institutions, as well as significant changes to lender operations. For support positions, licenses should be granted to individuals only, since expertise and liability are important. Business organizations can change ownership or personnel and thus lose expertise.

Okay Plan- once associations are strong and self-regulatory

Education requirements at this level should allow for bachelor's degree, especially if skill and experience are strong.

Recommendations. Additions to focus on licensing of lenders, as follows:

Job Description Manager of Licensing

This position will develop and implement licensing standards for mortgage lender activities, including initial market entry, branching, change of control, stock issue, merger, major new products and certain specific activities. Standards will also be established and administered for persons in professional support functions such as appraisers, real estate brokers, mortgage brokers, and title companies. The incumbent will also be responsible for developing partnerships with professional associations and the academic community to establish standards for qualifications, training, and ethics. [First sentence added; second and third sentences minor changes]

[Add: "This position reports directly to the Director of Industry Affairs."]

This role will also require experience managing professionals and will have responsibility for developing this unit in its initial formation. [Minor change; could be deleted as obvious and true of all managers at this level and above.]

Job Responsibilities

[Add Item 1] Develop and implement processes for licensing of mortgage lenders for initial market entry, branching, change of control, stock issue, major new products, and other major specific activities. Such processes should include application, processing, approval/denial, appeal, and documentation.

[Former Item 1; leave as is, except as noted.] Working with professional...for licensing of mortgage lending support professionals, including qualifications...

Assessing individuals' qualifications to meet licensing criteria. [Firms should not be licensed; mortgage lender licensing covered preceding.]

[Former Item 3] [Delete – Assisting and overseeing the development of training programs; too much responsibility; market should take care of this, though MFA should aid in providing advice and materials to parties developing and administering training]

[Former Item 4] [Delete; same reasons as Item 3; some redundancy also]

[Former Item 5] Handling inquiries... [Okay, but obvious as a standard organizational duty]

[Former Item 6] Building and maintaining relationships... [Again, okay, but obvious]

[Former Item 7] Supporting and assisting... [Same again, plus vague; what colleagues, internal or external? Latter could be a problem]

[Former Item 8] Sharing knowledge of best practices for support professionals—appraisers, real estate brokers, mortgage brokers, and other. [Some simplification of wording; emphasis on individuals, not companies]

Qualifications

Bachelor's degree in business (especially finance or real estate), law, or a related field; master's degree or higher preferred but may be offset with strong experience [this revision allows more flexibility with education/experience requirements]

Minimum of 10 years experience as a manager or professional in finance, law, real estate, banking, or a related discipline [some revision to focus more]

Experience in licensing of professional services is beneficial

[Items 4 and 5 okay]

Ability and confidence to prioritize and manage a large number of competing demands [combined Items 6 and 7, and revised for clarity and focus]

[Item 8 – deleted due to several problems; “drive” covered preceding; “independently yet closely” contradictory; “deliver results...solutions” again sounds like serving industry]

Willingness to take on new responsibilities and to develop knowledge and skills [some minor clarifying revisions; really just the qualities of an ambitious employee; could be deleted with little loss]

Manager of Monitoring and Enforcement. A key role in developing and implementing the regulatory process. Incumbent must have both strategic and technical grasp, as well as excellent people skills, with subordinates, managers, and industry personnel.

Job Description

Manager of Monitoring and Enforcement

[Initial paragraph fine. Third sentence, delete “then” since hiring should not wait on development of all standards. Last sentence should be revised: “Promotion of financial safety and soundness and ethical management will be key components of this office.”]

[Add: “This position reports directly to the Director of Industry Affairs.”]

Job Responsibilities

[For order of importance, recommend that Items 1 and 2 be switched]

[Item 2 – would revise slightly for better focus of terminology] Conducting on-going regulatory supervision of mortgage lenders, including gathering and analysis of information from lenders, to assess the various business and control risks, to identify weaknesses, and to determine necessary corrective action.

[Item 3 – Should be more specific; revise as follows] Supervising professional staff, including on-site examiners/ inspectors and off-site monitors, as well as support staff.

[Item 6 – potential problems if “relationship” is not more clearly defined; “wide range of firms” is unclear term; general problem also, of what level at MFA with what level at lender; would revise somewhat] Establishing and maintaining ongoing communications with senior management at regulated mortgage lending institutions.

Qualifications

[Item 1; revise] Bachelor’s degree in business (especially finance or real estate), law, or a related field; master’s degree or higher preferred but may be offset with strong experience [as with other job descriptions, this revision allows more flexibility with education/experience requirements]

[Item 2; add:] ...of mortgage lending industry.

[Item 3; revise] Minimum of 10 years experience as a manager or professional in finance, law, real estate, banking, or a related discipline [some revision to focus more]

[Item 4; add] ..., both written and oral

[Item 5; no change]

[Item 6; revise] Strong ability to analyze complex information, identify relevant issues, and to devise strategies to resolve them; excellent numeric/ quantitative skills.

[Revise language for clarity; delete “confidential” because not relevant to skill (confidentiality should, however, be covered strongly under ethical standards for ALL supervisory personnel); include Item 8 here, since closely related]

[Item 7; delete as redundant with Items 4 and 5]

[Item 8; delete and include in Item 6]

Manager of the Office of Industry Liaisons. This role is responsible for communicating concerns about the mortgage market, industry, and regulatory framework between MFA and industry participants. Communication must be fostered in both directions, and this function will be key in identifying emergent issues. But greater emphasis on the overall regulatory mission will limit importance of this role and resources dedicated to it.

Recommendations. Wording should be revised to reflect concerns discussed preceding. See also comments on organization in next section of this report. The job responsibilities have been more specifically defined, while allowing some flexibility for emergent issues. Some changes have been made in qualifications to conform to previous recommendations.

Job Description

Manager of the Office of Industry Liaisons

This department will be MFA's main contact point with mortgage lenders and other stakeholders on policy issues arising in the mortgage market. This manager will actively solicit industry opinion on new challenges and will cooperate with industry representatives, including stakeholder committees, to address issues of concern. The incumbent will also administer an outreach program to provide regulatory information to industry and support organizations.

[First sentence revised to be less allusive and more specific, focusing on policy issues outside the supervisory cycle of each lender. Other syntax simplified. Last sentence revised to shift from technical assistance to outreach.]

Job Responsibilities

[Item 1 – no change]

[Item 2 – revised to reduce technical responsibility, more clearly define constituency] Provide outreach, that is, regulatory information in written materials and seminars, to personnel working for lenders and support organizations.

[Item 3 – no change]

[Item 4 – some revision to define objective] Review regulations and industry opinions to determine areas where mortgage lending is hampered unduly and without sufficient benefit to safety and soundness of market.

[Item 5 – no change]

[Item 6 – no change]

[Item 7 – deleted, because training is addressed separately; also training is a responsibility of all managers]

Qualifications

[Item 1; revise] Bachelor's degree in business (especially finance or real estate), law, or a related field; master's degree or higher preferred but may be offset with strong experience [as with other job descriptions, this revision allows more flexibility with education/experience requirements]

[Item 2; add:] ...of mortgage lending industry.

[Item 3; revise] Minimum of 10 years experience as a manager or professional in finance, law, real estate, banking, or a related discipline [some revision to focus more]

[Item 4 – no change]

[Item 5 – no change]

[Item 6 – minor revisions for unclear syntax] Ability to manage and prioritize a large number of competing demands

[Item 7 – minor revisions; “independently yet closely” seems contradictory, and self-sufficiency and confidence are implied in other qualities]
Ability to work closely with team members and staff across a wide variety of industry groups, government, and the MFA

Other Recommendations. Professional staff (especially on-site inspectors/examiners) should be occasionally rotated (on temporary assignment) through support positions in Research, Policy, and Analysis and Consumer Affairs, and Legal Affairs (especially if they have legal background), as well as Office of the Chairman. This will give professional staff an appreciation of these departments and bring knowledge of these departments into the field. Likewise, such rotation would give these departments the benefits of knowledge from the field. The number of permanent staff in these support departments would also thus be reduced accordingly.

II. MFA Mandate and Status

Item 3 in Scope of Work

Assess if the MFA fulfills its mandate in terms of licensing, accreditation and registration standards as well as monitoring, inspection, compliance and enforcement standards.

Current MFA status

The basic assessment of this Item 3 is that MFA is *not yet* fulfilling its mandate. There are several good and understandable reasons for this, and MFA is making reasonable progress.

First, MFA's organization and operation are just beginning. Many factors, both internal, and external in the mortgage market, need to be resolved and operating.

At the time this research was commenced, in late August 2005, a new chairman had just begun work, and few staff had been hired. More recently, mid-November 2005, some progress has been made in staffing and setting up the organization. Three middle managers in supervision and one important advisor have been hired. Financial reports from lenders are being received and reviewed. Little on-site supervisory activity has taken place.

In the mortgage lending market itself, a few lenders are operating, with lending volume at a low and tentative level. These lenders appear well capitalized and with capacity for a much higher volume of lending. The necessary supporting professions of appraisers, real estate brokers, and loan brokers are only just starting to develop.

Changes by government have not helped. Interviews with current and potential investors in the mortgage market pointed out that the several changes in MFA chairman and in responsible ministry have sent signals of instability and lack of commitment which are discouraging to investors. Some investors are waiting to enter the market. Others already in the market are limiting investment and business taken on.

In addition there exist numerous significant obstacles which must be overcome to create a vital, active mortgage market. These are outside the scope of what is discussed in this report but include a wide variety of known issues, such as property registration, chain of title, enforceability of mortgages and other contracts, enforcement of possessory rights, costs and sources of funds, establishment of supporting professions and ethical and other professional standards, appraisal standards, comparable sale property data, high interest rates and other prohibitive terms, lack of verifiable consumer data for underwriting, and consumer education. These factors have varying degrees of urgency, importance, and achievability.

Some current market problems must be solved indirectly. For instance, in a free market, mortgage rates cannot effectively be reduced by direct government mandate. If such a law were to be passed, lenders simply withdraw from the market because it is not profitable. The cost of funds and risk are two important factors affecting mortgage interest rates.

Recommendations to organization and functions

To facilitate the MFA's capacity to meet its mandate, the following recommendations are made. Some of these revisions were reflected preceding in the proposed job descriptions discussions.

- Emphasis on primary supervisory focus, including legal and regulatory framework development and inspection and monitoring of lenders.
- Emphasis on licensing of new lenders; additional licensing on changes/starts in major lender activities; additional licensing of supporting professions.
- Reduction in importance of consumer and industry liaisons; revisions to organization.

Monitoring and Enforcement. The *primary mission* of MFA should be to establish and administer a legal and regulatory framework that promotes a safe and sound mortgage lending industry and that thereby facilitates mortgage finance as a consumer benefit and as a positive economic force. Such a regime, if consistently and fairly applied, will foster healthy lender competition.

Consumer education and liaisons with the mortgage industry are important also, but should be secondary. Also, it should be recognized that there is probably more need for these activities during the initial phases of development of Egypt's mortgage industry. Where conflicts arise between these roles, MFAs role as regulator should always prevail. Because organizational charts seem to show a uniform distribution of responsibilities, there could be a tendency to overdevelop the Consumer Affairs Department and the Industry Liaisons function (which is under the Industry Affairs Department).

Consumer Affairs. Two revisions to the Consumer Affairs department are recommended. First and most important, a redeployment of Disclosure Standards and Guidelines. This function should be split into two: 1) establishing consumer disclosure standards (set out in regulations) and 2) enforcement of those standards. Responsibility for standards should be moved to the Legislation and Regulation function, and enforcement to the Monitoring and Enforcement function under Industry Affairs. In developing and maintaining these standards, it is important that the Legislation and Regulation function be in active contact with Consumer Affairs to receive its contributions.

Consistency is important in helping consumers understand mortgage information. So disclosure regulations should be developed and maintained without constant revision.

Consumer Liaisons function would retain two roles: 1) providing information to consumers about the mortgage process, and 2) hearing consumer complaints and concerns.

The Ombudsman is an important, though informal, function focused on non-binding resolution of disputes between consumers and mortgage lenders. Though this function is somewhat redundant with the responsibility of Consumer Liaisons, its role is more focused and independent. The Ombudsman can act as a mediator, or even arbitrator if agreed, to settle disputes before they escalate into the court system. On the other hand, Consumer Liaisons can handle more general opinions and complaints, for instance, to do with policy and disclosure matters.

Both the Ombudsman and Consumer Liaisons can provide important information for the Monitoring and Enforcement, as to possible lender violations and abuses, and to Legislation and Regulation, as to disclosure regulatory framework.

The second, more minor, revision relates to providing consumer information from the Consumer Liaisons function. Though there is some benefit and need for MFA independently providing consumer information (such as through publications, seminars, press conferences, and maintenance of a web-site), this role should *primarily* evolve into a cooperative effort with mortgage lenders, support professionals, and industry groups. This approach will provide for better uniformity of the products, less resources used, and better relations with the industry.

Licensing. According to the proposed job description, the licensing function would be limited mostly to support professionals, such as appraisers, loan brokers, and real estate brokers. This is of course much too limited.

The licensing function most importantly includes the licensing of new mortgage lenders entering the market. It is critical that these new lenders are adequately capitalized, and are owned and managed by persons with sufficient lending experience and of sound moral character. Even without citizen deposits, risk of lender failure through incompetence or insider abuse can be prevented to a large degree by adequate investigation during the licensing process.

In addition, regulatory approval should be required for other major changes to institution operations, including change of control, branching, stock issue, merger, major new products, and other major specific activities, including discontinuation of major operations or services. Such processes should include application, processing, approval/denial, appeal, and documentation. (Some are in REFL.)

Industry Liaisons. This role is responsible for communicating concerns about the mortgage market, industry, and regulatory framework between MFA and industry participants. Communication must be fostered in both directions. But with a greater emphasis on the regulatory mission this role has its limitations.

It should not become an internal “lobbyist” or advocate for industry interests, nor should it be the primary technical trainer for industry personnel. On the other hand, MFA must be sensitive to issues that could be detrimental to the mortgage market, and MFA must communicate effectively its regulatory concerns.

Sometimes regulators and lenders will not be able to agree, and the industry must not be allowed to undercut, politically or otherwise, a strong but fair supervision regime. A knowledgeable lender in fact welcomes strong supervision because it limits unfair, and sometimes ruinous, competition by requiring uniform standards of performance and fosters a healthy competitive industry. In addition, training of industry personnel is an ambitious undertaking and should be mostly handled by the industry itself—individual lenders and industry associations. MFA should, however, support these and should facilitate understanding of new laws and regulations through an outreach program.

This position, and the department it supervises, will have less scope and fewer professional personnel than the two departments of Licensing, and Monitoring and Enforcement. This role may evolve during and after initial industry development, though it will always be an early warning system for emerging issues.

III. Regulatory Framework

Item 4 in Scope of Work

Provide recommendations and assist EFS Legal Experts in drafting regulations and procedures to fill identified gaps. High priority gaps should be addressed first. Also, need to address the issue if recommended regulations will conflict with those issued by the CBE.

Introduction

Purpose and Method. This section evaluates MFA's regulatory regime in comparison with established "best practices" acknowledged and used by regulators of financial institutions in countries with highly developed economies. Differences and gaps in MFA regulations are identified and discussed and recommendations for resolution are made. Actual detailed drafting of regulations is beyond this scope of work; rather, important principles of such regulations are given.

Gaps between the Real Estate Finance Law and Regulations are identified in Appendix A, which provides a section-by-section comparison, with comments and recommendations. Many of these are technical and even minor, but gaps considered material have been addressed in this main section of the report also.

Some shortcomings MFA may choose to address less formally, with a memo or statement of clarification issued by MFA to lenders. Such are so noted.

To facilitate accordance with regulations of the Central Bank of Egypt (third sentence of Item 4 of scope of work), a separate section discusses an overall strategy and alternatives, rather than trying to address each regulation specifically.

Models for best practices. The mortgage lending market of Egypt, especially as it is envisioned, constitutes a specialized type of financial service provider with particular concerns. First, this type lending is more specialized than the wide range of loans made by banks, being limited to housing and other real estate related loans, which have their own particular risks. Secondly, mortgage lenders will not take deposits, but will rather fund loans from their own capital, from borrowings, and eventually from the sale of loans. Despite these differences, it is argued that the western bank regulation model demonstrates a sound basis for regulating the Egyptian mortgage market.

Banks are more highly regulated than other businesses because of their importance to the economy as financial intermediaries. Protection of citizens' deposits, payment/transfer operations, and funding economic growth with loans are the most key functions usually cited as factors fostering and stabilizing the economy. Though Egyptian mortgage lenders will not take public deposits nor perform transfer functions, their regulation is important in a number of risk areas. Housing is important to the economy and to the lives of its citizens. The housing inventory represents a substantial part of the assets of the country, and housing is usually by far the largest asset of a typical household. Readily accessible mortgage funds facilitate a fluid housing market, easing transactions.

Mortgage lending is just beginning in Egypt and is subject to various start-up risks also, including lack of consumer acceptance, potential for predatory lending and other abusive practices. Lack of lender stability can reduce consumer confidence,

cause shocks to the real estate market, and reduce capital flows contributing to economic growth.

Though no deposits will be taken, consumer funds may be at risk during construction, during the closing process, or during post-closing as escrow funds are held until title is cleared or other work is performed. In addition, consumer equity in the real estate is at risk until the mortgage is paid off and the title is clear. This risk could be especially substantial if lenders must adopt a security regime wherein title to the property is held by the lender (or third party trust) until the loan is paid off completely.

Good sources for such regulatory standards are those issued by the Basel Committee on Bank Supervision and by the several bank supervision organizations in the United States and other countries. Of these, the U.S. Office of Thrift Supervision (OTS) is responsible for savings associations, a type of depository institution that specializes in real estate lending. Non-depository mortgage lenders, such as mortgage banking operations, are not directly regulated. Instead, to package and sell their loans, they must meet documentary, underwriting and other standards set by the two main purchasers of mortgage loans, the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). These two organizations are in turn regulated by Office of Federal Housing Enterprise Oversight (OFHEO). Thus, non-depository mortgage lenders in the U.S. could be considered to be regulated, in a *de facto* manner, by these two quasi-government organizations. Many performance standards, such as appraisal and loan underwriting, are essentially the same for both OTS and these two secondary-market lenders. (See Appendix C)

Drafting of Regulations. The writer of this report, though he has attempted to understand the Law and Regulations, is not qualified to practice Egyptian law. In drafting and implementing the regulations proposed herein, responsible managers within MFA will need to work closely with MFA attorneys to ensure compliance with Egyptian legal conventions and relevant existing laws. It is recommended that these regulations be developed in relevant and separate parts, rather than as a single all-inclusive instrument. This modular approach will allow prioritizing of more urgent revisions more quickly, and will make subsequent revision more convenient. In some instances, official correspondence from MFA (rather than regulatory revision) may be adequate for clarification. In other instances, the Law itself may need to be revised to grant authority for achieving regulatory goals.

In addition, regulations should be exposed to lenders and other residential market stakeholders, such as appraisers and real estate brokers. Though these regulated persons and organizations should not be given authority to draft regulations, their insights can be critical for developing useful and enforceable laws and regulations.

General principles for a regulatory regime. To establish basic safety and soundness principles within a lending market, certain general areas should be covered by regulations. These usually include the following. Regulator judgment and discretion are important in enforcement of regulations. Note that there is some inter-relationship among these parts.

Capital adequacy – founding capital standards, capital ratio, other capital measures

Asset quality – Loan types authorized; underwriting and documentation; asset classification and loss reserves; collections, foreclosure and loss recovery; other loan-related matters; insider transactions

Licensing – Lender entry into market, major lender changes; supporting professions

Management and corporate governance – Accounting systems; internal control, internal and external audit; policies and procedures; goals and monitoring

Financial performance – Growth, earnings, liquidity and funds management, asset-liability management; prudential reporting; business plans and budgets

Supervisory actions – Prompt corrective action; fines and sanctions; license revocation; closing, merger, consolidation, sale, liquidation

Consumer protection – Disclosure requirements; predatory lending practices

Related entities – Holding companies and other parents; subsidiaries and affiliates

Anti-money-laundering and combating financing of terrorism (AML/CFT)

Key Issues and gaps in mortgage finance regulations

MFA responsibility and the Central Bank of Egypt.

Bank lending and supervision. Some commercial banks currently already make mortgage loans, or at least loans on real estate, whether or not they are secured by the property itself. Real estate loans are authorized for banks by Article 3 of the Law. It is likely that, as obstacles to mortgage lending are overcome and consumers become more aware of the benefits, banks will be more active as mortgage lenders. They may make mortgage loans through established lending functions or through specially created mortgage subsidiaries.

Egyptian banks are regulated by a division of the Central Bank. An interview with Deputy Governor in charge of bank supervision at the Central Bank disclosed that the unit has begun to use western “best practices,” including CAMELS and risk management. Their examination manual, however, has no special section or provisions for regulating mortgage lending or mortgage subsidiaries. Though no review of CBE regulations was undertaken, it appears likely that mortgage loans in banks are regulated only by regulations pertaining to loans generally.

Compatibility. At the least, supervision of mortgage lending must be compatible between MFA, CBE, and other relevant regulators, in order that some lenders not get an unfair competitive advantage due to a lax regulatory framework and to prevent failures and instability in one sector of the mortgage market.

Review of drafted regulations. Since MFA is the primary mortgage finance regulator, it should continue to have primary influence for drafting of mortgage regulations. During the drafting stage, new regulations and revisions should be routinely submitted to a joint committee including member from MFA, CBE, and other regulators to resolve any disagreements or contradictions in law or regulation. Though it is less likely such contradictions will appear in the early stages, as the mortgage market continues to develop and regulations evolve new issues will need to be addressed, and this arrangement will facilitate continued accord.

Supervisory responsibility and cooperation. MFA has authority to regulate all mortgage finance companies, and this would seem to extend to subsidiaries of banks. Because of MFA's organizational expertise, as it is to be developed, it is likely that CBE would allow this. An ideal arrangement would be for CBE to grant blanket approval for MFA to supervise bank mortgage finance subsidiaries, with both organizations fully cooperating in scheduling, deployment, submission of interim financial reports and sharing of any MFA analysis and reports. An important point of cooperation could be the training of relevant bank supervisory personnel in mortgage lending and its regulation and the sharing of supervisory manuals and similar technical materials.

Regulation of mortgage lending within banks could be more problematic, since that function would be more difficult to separate. If handled in a specific department, mortgage lending could be rather directly regulated by MFA much like with a subsidiary. Either way, MFA personnel entering a bank will be a concern to the CBE, which will want to control the process at least somewhat. MFA examiners could be assigned, for instance, to accompany bank inspectors during a regular on-site examination.

Occasional mortgage loans in banks are of less concern to MFA and would not normally require its on-site presence, assuming adequate training and expertise of CBE supervisory personnel and sharing of pertinent on-site examination reports and off-site financial reports.

Written Agreement. It is recommended that a memorandum of understanding be discussed and negotiated between the two authorities, even if MFA does not participate in regulating banks at all. Such document would set out responsibilities and bases of cooperation, the sharing of bank-submitted reports and on-site examination reports, corrective actions, and similar relevant matters. The initial memorandum need not be comprehensive or highly detailed, because the relationship between MFA and CBE will evolve as the mortgage finance market evolves. Such a memorandum should be reviewed by both parties at least annually, particularly during the first years.

Capital adequacy

This area includes regulations governing founding capital standards, capital ratio, other capital measures.

Summary Assessment. The current capital regulation is adequate for the near term, though it needs further clarification. A risk-based method for calculating the requirement should be developed in the near future.

Current capital requirements – From the regulator's viewpoint, the capital level is important for absorption of major losses, in the extreme case protecting the lender and the market in the event of losses and even liquidations. Article 28 of the Real Estate Law appears to give MFA complete authority to set this requirement in its Executive Regulations. Minimum founding capital requirement is set at LE 50 million (Article 27 of Regulations), though investment terms allow 25% down and the remainder within one year. This provision thus sets a minimal organizational size and limits entry into the mortgage lending market.

The ongoing capital requirement is calculated as a ratio to assets, which is set at a minimum of ten percent (10%) (Article 35 A of Regulations). Law and regulations do not contain a detailed definition of capital, to ensure only permanent non-cumulative investment qualifies, though this may be covered elsewhere in Egyptian law. The simple denominator of total assets does not weight the different risks for different types of assets and does not recognize other risks, such as commitments and other off-balance sheet items, or the portfolio of loans serviced but not owned.

Basel capital standards have some useful applicability here. A caution, however--The newer standards (usually referred to as Basel II) apply to large multinational banks and are generally too complex to be applicable to mortgage lenders in the Egyptian market.

Recommendations.

Leave founding capital requirement in place, though it should be reviewed from time to time for its level. Should consider not allowing payment of remainder of capital later, because of difficulty of enforcement.

Issue a detailed definition of permanent capital if a suitable one does not already exist in Egyptian law. An important provision should ensure that funds for capital investment have not been lent by the mortgage company to its owners.

Replace the existing capital ratio regulation with a risk-based calculation, whose denominator (now total assets) would be replaced with a summation of percentages of assets and other measurable factors (such as commitments and other off-balance-sheet items). This framework should be developed along the lines of similar existing in Basel capital accords, and OTS and FFIEC capital requirements. For subsidiaries of banks, this risk-asset requirement could apply within bank balance sheet as an additional requirement over that of CBE.

Asset quality

This area includes regulations covering the following subjects:

- loan types authorized;
- loan underwriting and documentation;
- asset classification and loss reserves;
- collections, foreclosure and loss recovery;
- other loan-related procedures;
- insider transactions.

Two other important aspects of this area are *loan accounting*, which is discussed under Management and Corporate Governance (Accounting Systems) and under Financial Performance (Prudential Reports) and *reporting to consumers*, which is included under Consumer Protection.

Summary assessment. This area is generally weak and requires some serious additions and revisions to regulations. Loan types mortgage lenders can make are basically defined, but could use clarification and elaboration. Very little regulation exists pertaining to loan underwriting and documentation. No regulations appear to exist for asset classification and loss reserves or for insider transactions. The law sets out basic procedures for foreclosure, but little on collections or loss recovery.

Loan types authorized.

Law and Regulations allow loans type identified by purpose, for “the purchase, building, repair, or improvement of houses, administrative units, service installations and buildings of stores appropriated for commercial activity.” Refinances (loans on property already owned and occupied) are not yet allowed. More potentially troublesome is inclusion of authorization for retail and perhaps other undefined types of commercial property. These have a significantly different risk profile from single-family owner-occupied housing. Lending limits should be established on these riskier types of loans, including construction loans. Also, some, especially not appurtenant to single-family owner-occupied housing, perhaps should be prohibited, at least during a transitional period.

Lending limits on particular types of loans *while they are held in the lender’s portfolio* are an established method of controlling risk. Such limits can be set according to lender total assets or portfolio size or capital. Article 3 D of Regulations limits lending to any borrower and its affiliates up to 10% of capital. For lenders using an active secondary market, where originated loans are quickly sold and the lender regularly buys and sells loans and/or mortgage-backed instruments, capital would be a more stable measure, since portfolio and asset size may change greatly and often. Capital is also a good gross measure of an institution’s ability to withstand loss.

Loan-to-value ratio – Maximum is currently set at 90% (Article 3 B of Regulations). “Value” is not clearly defined. Reliability and accuracy of appraisals are an issue at the present time (not discussed here), since these are an important estimator of value. From experience in other developed markets this ratio appears too high. In addition, no distinctions are made for different loan types and their differing risks. No other mitigating factors are given, such as volume limits or mortgage (default) insurance.

Recommendations

- Regulations should make a distinction as to risk among loan types. These risk factors may be adjusted over time as the market and legal infrastructure develop. (e.g. secured loans are not necessarily less risky if the security cannot be acquired or disposed of)
- Add loan volume (% of capital) as a limitation, for each type of loan allowed; retain current limit of 10% of capital on loans to one borrower and affiliates.
- Low risk loans would be initially defined as those fully-amortizing first mortgage loans to owner-occupants. No volume limit. 90% loan-to-value ratio. Important issue at present is whether lender’s security interest can be executed, so this definition may need to be postponed.
- Similar residential mortgage loans not meeting all these criteria would be subject to lower loan-to-value ratios and some volume limits.
- Construction loans and loans on commercial property should be limited in volume (% of capital) and have a lower maximum loan-to-value ratio. (for instance, 75% on residential construction loans, and 60% on non-residential loans) Additionally, underwriting standards should be more stringent.
- At a later date, as the system is more developed, refinance loans should be permitted on owner-occupied housing.
- Some small volume allowance should be made for non-conforming loans, defined as those of low risk, but which do not meet some minor criteria.

Loan underwriting criteria

Loan underwriting is usually defined as the lender's evaluation of likely loan performance and the likelihood of recovery of loan proceeds. Underwriting results in a decision to make or not to make the loan. It includes underwriting of the borrower and the security property. The borrower is evaluated as to his ability and willingness to service the loan, through his credit payment history, income from salary and other sources, equity invested in the property, cash and other assets, and other debt. The property is underwritten with an appraisal estimating value. Other criteria are important also, including sale price, location, title requirements, curability of encumbrances, survey (for property description and physical/legal influences), and other records, documents, and services establishing that improvements are adequately constructed and have adequate access to utilities for their use.

The term "borrower" as used herein includes all persons assuming obligation under the loan, including persons with additional income or assets necessary for the loan to be approved.

Summary Assessment. Regulations in this area are weak, but issues in the market will make it difficult for lenders to comply with recommended regulations. Many criteria are difficult to quantify or formalize.

Borrower loan-to-income ratio – Regulatory maximum sets debt installment at no greater than 40% of borrower income (Article 3 F of Regulations), which is similar to guidelines used in developed markets. (Exception is instances of subsidized low-income lending covered by a separate provision.) This ratio is basically conservative, but does not allow lender flexibility. Could prevent predatory lending.

Borrower income verification – Borrower employment and salary should be verified and previous employment if current employment is new. If borrower is self-employed or has other income to be counted, such income should be verified by tax returns and other verifiable documents. Section 3 E of Regulations requires employer's statement and/or income tax documentation.

Borrower credit history - A credit bureau report should be obtained and analyzed and any adverse data resolved. Such reports should show debt and other regular expenses (such as municipal services and utilities) and rate timeliness of payments. Besides credit report, verifications can be obtained from financial institutions having a loan history and perhaps through utilities and others with monthly billings.

An additional issue is the problem of underwriting a borrower who is still unresolved seller on another deal. The limitations of property transfer and establishing registration and chain of title in this market often causes the seller to remain with interest in the property for some time after the sale transaction.

Borrower equity in property – This amount is set by the loan-to-value ratio, the difference between the sale price and the loan amount being the amount the borrower has to contribute. Since the borrower is at risk of losing equity in the event of default, this provides a strong incentive for repayment. In the application process the lender should verify that the borrower will be able to bring sufficient funds at closing. Funds should not be lent to the borrower by the seller.

Borrower assets – Savings deposits should be verified with the financial institution holding them. Deposit verification should also be used to find whether the borrower had debt at that same bank. Other major assets should also be verified if important to approval of the loan. For commercial loans, financial statement analysis can necessarily be quite extensive and may require audited borrower statements.

Appraisal report – The written appraisal report estimates the security property value, from which the loan amount is set. In addition, the appraisal presents other information about the secured property and its market which are very useful for the lender. Articles 44 to 48 of the Regulations (with a reference to Article 22, which gives conditions for appraisals during forced sale of security property) set out basic duties of the appraiser and prohibit conflicts of interest. But methods and professional standards are not addressed at all.

Basic standards for data, form, content, and analysis exist in the U.S. model and could be adapted here. (U.S. Professional Appraisal Practices (USPAP) or similar standards) A significant problem in this market is getting reliable property sales data. Registration problems are only part of the problem. For support data, an appraiser will need widespread disclosures of actual sales prices, along with terms, property identification, and property description.

Recommendations. Though underwriting requires judgment as well as quantified rules, many criteria have become standardized over time in developed markets.

Issue regulation requiring lenders to have written underwriting policies and standards, approved by their board of directors and in compliance with Egyptian laws and regulations. These policies should be in conformity to the lender's overall business plan.

At a minimum, such policies should include the following matters:

- Definition of types of loans that the lender is authorized to make, including purpose, repayment terms, loan size, type security property, nature of secured interest (Such as first or second mortgage, or unsecured. Actual loans made may be limited at certain times due to management strategy; loan terms such as interest rate, loan-to-value ratio, amortization period may be reviewed and changed regularly by management according the lender strategy and market conditions.)
- Approval authority required for each loan type. Lists of names of individuals and committees (and members) along with approval levels. Larger and more complex loans should require increasingly higher authority. Board of directors should ratify new loans monthly. Individual lending personnel should not have excessive approval authority. Internal audit and other functions should provide oversight and ensure policies, standards, and regulations are being met.
- Limitations on lending to insiders, including owners, officers, directors, employees, and affiliates
- Minimum appraisal standards, according to loan and property type; reference may be made to uniform standards adopted by a professional appraisal organization
- Maximum loan-to-value ratio for each loan type. Maximum LE sizes allowed.
- Percentage capital, portfolio, and other limitations on loan types.
- Loan register, showing applications and status, including reasons for rejection.
- Loan application form and checklist and example forms of financial, credit, employment, and other information needed for application to be considered by approving authority.
- Minimum file documentation required, with guidelines for evaluating such information during loan processing prior to approval, at closing, and after. (See separate regulation)
- Minimum standards for loan approval, including loan-payment-to-borrower-income ratio, total-debt-to-borrower-income ratio, sufficient verifiable cash for

closing of sale, credit history evidencing reliable repayment of debt, and similar items.

- Guidelines for limited flexibility in approval where weakness in one area is more than offset by strength in another

Issue regulation setting out minimum credit underwriting standards. Such standards will vary according to the size, type, and complexity of loan and should be set out in the lender's underwriting policies and procedures. (See preceding discussion) The purpose of credit underwriting is to evaluate the borrower's ability and likelihood of repayment of the loan. For standardized consumer loans, such as home mortgages, rather uniform standards can be developed and covered in regulations. For construction and commercial loans, however, data and analysis required can be quite complex and are difficult to quantify and write into regulations. Minutes of meetings of all committees and board should show all loan approvals and ratifications. Documentation that these standards are being applied is evidenced in the loan file. (See following section on Loan File Documentation) Regulations should address the following matters:

- Clear identification of all borrowers to be liable on this loan
- Borrower financial information, including all assets and debt
- Verification of major assets, such as deposits and bank accounts; borrower cash should be sufficient to cover equity and loan closing costs
- Verification of past performance on debt from credit bureau report and/or statements from lenders
- Verification of income through employer statement and/or tax information; audited financial statements may be required on major commercial loans
- Borrower income should be sufficient to service loan repayment, as well as other existing borrower debt; percentage relationship should be set out in policy and regulations
- Loan approval by authorized body; signatures of officers approving

Issue regulation setting out minimum appraisal standards. Reference should be made to acceptable and established professional practices as guidelines. More detail on appraisals may be issued as memoranda to industry lenders and appraisal professionals. Very importantly, the detail and complexity of appraisal reports should reflect those of the property. Standardized forms may be developed for residential properties. Commercial properties will usually require lengthy narrative reports.

Some minimum residential appraisal standards should include:
(have AI consultants review)

- Report must be in writing.
- Identification of property, including property type and description sufficient to support the analysis. Property should be identified as existing (and physical age) or proposed, and appraised value "as is" or "as if completed" or other contingencies. Any significant problems or conditions affecting the value must be disclosed. Disclaimers should be given for issues the appraiser is not qualified to address.
- Photographs and identification of subject property and all comparable properties. Diagram showing floor plan of subject improvements.
- Name of appraiser(s), and any professional designations. Statement that he has no present or contemplated future interest in the property and otherwise complies with ethical standards. Appraisers' signature(s). Statement as to

whether the appraiser has physically inspected the subject and all comparable properties.

- Date appraisal was completed. "As of" date effective for final value estimate.
- Land value estimate as if vacant, as part of cost approach.
- Three approaches to value, each giving a separate estimate: cost, income, and direct sales comparison, all analyses being performed according to established professional practices and supported by verified data, including sales and rental comparable properties. Persuasive reasons must be given for any approach not used.
- Analysis, reconciliation, and final estimate of value.

Loan file documentation

The permanent loan file should contain all documents pertaining to loan application, approval, and closing. Also included will be any follow-up documentation, including for instance insurance policies, documents related to clearing of title, or necessary repairs. A typical exception will be the accounting for borrower loan repayments after closing, which will included in the accounting system of the lender or loan servicer. Loans in process and commitments should contain all documentation accumulated to that time.

Loan file documents should evidence prudent practices, regulatory compliance, and protection of lender interest. Such documents will vary with the size, complexity, and type of loan. Some minimum standards are considered prudent for home mortgage loans.

Recommendations.

Issue regulation setting out standards for minimum loan documentation. Borrower(s) should sign all encumbering documents and sign receipts or other evidence to show reviewing and receiving disclosure documents. The loan file for a typical home mortgage loan secured by a residential property should as a minimum contain:

- Note and any other lending agreement and evidence of debt; should set out all terms and conditions of debt; should be signed by borrower(s) and dated along with mortgage and any other document establishing lender's security interest; should be signed by borrower(s) and dated
- Multi-party Finance and Transfer Agreement, if necessary to resolve problems with registration and clearing of title; should be signed by borrower(s) and dated; sale contract if separate
- Loan settlement statement, showing receipts and disbursements of all funds in closing and all funds escrowed for curing requirements after closing
- Evidence property taxes have been paid, and escrow set up for amounts due
- Consumer disclosure statements required by law or regulation--duplicate originals evidencing receipt by applicant
- Documentation of loan approval by proper lender authority; signatures of officers approving
- Loan application (completed and signed by borrower), including date, borrower information, purpose of loan, identification of security property, type and terms of loan applied for.
- Other relevant borrower information (for all borrowers), including financial statement, income verification (including tax information if necessary), deposits verification, credit bureau report, loan history at this or other lenders.
- Survey identifying securited property land and improvements and any easements, encroachments, or other encumbrances.

- Property appraisal report, completed according to established standards. (see preceding section)
- Attorney's title opinion and/or evidence of title, showing chain of title and ownership at closing and after, when new owner is registered; title insurance policy if applicable; evidence that necessary items have been resolved providing clear title and/or escrowing of funds sufficient to resolve pending matters.
- Evidence that property use is in compliance with law, including any zoning or other municipal or governmental limitations, with all utilities available, and property accessible to owner; if newly constructed property, evidence from municipal authority that property can be occupied.
- Documentation of satisfaction of any other governmental requirements
- Evidence (such as copy of policy) of adequate hazard insurance, including fire, casualty, and liability; evidence that policy has been paid and funds have been escrowed toward renewal of coverage
- Any other documents necessary to establish underwriting procedures and/or to protect lender's interest on this particular loan; construction loans should have documentation covering disbursements and periodic property inspections in support thereof
- File documents checklist

All documents must be complete and correct; none of these documents should be missing without a compelling justification documented within the file. Pending documentation and actions should be noted on the checklist and attended by a loan officer.

From time to time MFA may issue memoranda of clarifications, exceptions, or additions to these requirements.

Loans for improvements or construction or to be secured by commercial properties will have additional requirements, according to standards established by MFA.

Asset classification and loss reserves

In most regulatory regimes, lenders are required to grade loans throughout their repayment term according to their performance and any actual or potential weaknesses. On the lender's books, periodic loss provisioning is performed, wherein potential losses from classification are recognized through the income statement and a reserve is set up as a contra account on weak loans or classes of loans. Loan repayment performance should be routinely reported from the books of the lender, and for mortgage loans and others with regular periodic payments, delinquency reports should be regularly prepared.

Residential mortgage loans are characterized by two aspects which can help standardize this process. Regular loan payments permit the lender to see promptly if loan performance weakens. Such degree of delinquency can be used for grading loan performance and asset classification. In addition, the appraised value of the security property, if it has changed during the life of the loan, can provide a reliable indicator of loss potential. This is true if and only if acquisition through foreclosure is reliable and reasonably quick.

Other major assets including consumer leases, liquid and other investments, and loan servicing portfolios should also be reviewed for weaknesses and loss reserves set up where needed.

Summary assessment. These principles do not appear to be addressed in law or regulations. They are a significant method for controlling loan and other asset risk.

Recommendations.

Issue regulation requiring lenders to establish and administer an asset classification process and setting out certain regulatory requirements. Regulatory provisions should include the following matters:

- Lender should establish policies and procedures on asset classification and loss provisioning and reserves; actual and potential losses should be recognized through the income statement; policies should provide for regular asset classification review and give guidelines and criteria for classification and loss provisioning; policies must be approved by the board of directors
- Lender accounting system should provide effective reports on loan repayments, including delinquencies and should reflect provisioning, loss reserves, and recoveries
- System of asset classification should include five increasingly severe levels according to international standards, including Pass, Special Mention, Substandard, Doubtful, and Loss or a similar grading system.
- Loss reserves should be set up at time of changes in classification; suggested guidelines for loss provisioning are: Pass (0-2%), Special Mention (10-15%), Substandard (20-25%), Doubtful (35-50%), and Loss (75-100%).
- Classification process should be documented to show reasons, including delinquency, missed maturity, capitalized interest, lender forbearance, non-conforming loan terms, deterioration of borrower financial capacity, deterioration in value of security property, and any similar relevant information.
- Any improvement in classification must be well-documented and should only occur in instances of compelling reasons, such as repayments bringing loan current or payment significantly reducing loan amount.

Collections, foreclosures, loss recovery

Lenders must have procedures for handling non-performing loans during the repayment period. The status of a given loan, as set out by the asset classification procedures, can be a criterion for what actions should be taken to attempt to return the loan to performing, or at least preventing its status from deteriorating further.

Registration and Foreclosure. This issue must be resolved to make the market's legal structure attractive to lenders and their investors. Unless the lender can acquire the security property in event of default, mortgages offer no risk mitigation. Resolution of this issue is beyond the scope of this report. Rather detailed procedures have been set out for registration (Articles 10 and 11 in the Law and Articles 12 through 16 in the Regulations) and for foreclosure and sale (Articles 12 through 27 in the Law; and Articles 17 through 26 in the Regulations). Nevertheless, all lenders interviewed believe the process will fail because of the actions of magistrates, who routinely fail to apply the law or to enforce contracts. Another important component is the long history of favoring the tenant, so that eviction itself is almost impossible. Upgrading the court system through education or more laws or other means is a slow and difficult process at best. Necessary independence of the judiciary will also be an obstacle. Several interviewees suggest that procedures must be removed from reliance on the actions of magistrates.

There may be means of doing this through public policy and minimizing the involvement of the courts. For instance, the process could be performed as set out

now with an agent-in-foreclosure executing the process, but overseen by a committee appointed by and answering to the MFA or some other body, such as a ministry. To cover the work-load a committee could be appointed for each municipality or other political subdivision. Similarly procedures could also be set out in the initial loan contract, so that the borrower must agree on such a remedy going into the deal. Another possible option is for property ownership to be held by a trustee until the loan is paid off, similar to deed-of-trust jurisdictions in the U.S. Ultimately however, the citizen has the right to sue, to seek redress in the courts, and this can throw any contract, and indeed the whole lending system, back into a court system that cannot be relied upon to enforce contracts fairly.

Sales procedures for real estate owned should reflect fairness and should prevent conflicts of interest, as by prohibition of sale to employees, officers, or affiliated persons.

Recommendations

Issue regulation requiring lenders to have policies and procedures for handling non-performing loans, whether in their own portfolio or serviced for others, with the goal of minimizing loan losses. Such policies should be approved by the board of directors. Such policies should include the following items:

- Grading of loan performance matched with collection action(s) to be taken; contact with customer should have increasing severity according to degree of nonperformance and responsiveness of borrower
- Documentation of actions taken by lender, including loan identification, collections officer, loan status, type action taken (e.g., letter, telephone call, visit, office visit, attorney letter), date, result or status (e.g., promise, payment, payments brought current, no contact after repeated attempts, property abandoned)
- Criteria for lender attorney action and initiation of foreclosure or other litigation; approval level required; criteria for reinstatement of loan
- Foreclosure process and eviction of owners
- References to existing law or regulation governing each stage of action
- Management of foreclosed real estate owned; appraisal, inspection, maintenance, rentals (if applicable), listing for sale
- Documentation of sale efforts
- Sale with financing; non-conforming financing to facilitate sale
- Ethical rules and prevention of conflicts of interest; prohibition of sales to affiliated parties

Other loan-related procedures

Loan processing and servicing. Besides credit underwriting, appraisal, loan documentation, and managing non-performing loans and foreclosed assets, other procedures will need to be in place to protect the lender's interest. These usually relate to organization, responsibilities, work flow, and specific procedures for certain types of loans, during the application, approval, and closing processes, but also afterward during loan repayment. Loans and participations may be serviced for others. These aspects are usually too highly varied to be set out in regulations. The lender should, however, have written procedures applying to its operations. A few instances are discussed following:

Construction loans. Even when secured by residential property, construction loans are subject to extra risk. Construction can be stopped or abandoned, or the contractor can run out of money or go out of business, leaving the secured property

incomplete. Construction can be poorly performed or use substandard materials, resulting in a lower appraised value. Municipalities and other governmental authorities may not accept or approve the work. Loan funds can be over-disbursed, so that sufficient funds do not remain for completion of construction. The lender must adopt and administer inspection and disbursement procedures for construction loans that are sufficient to protect its interest.

Property improvement loans. This type loan, for remodeling, rehabilitation, adding a room, or similar purposes, may have less risk due to its lesser size. But as with a construction loan, funds can be over-disbursed, and work can be stopped or not performed adequately. Similar, though simpler, inspection-disbursement procedures should be adopted.

Non-residential loans. Unsecured loans or loans secured by other types of real estate or other types of property will have higher risk because they will likely have less chance for recovery. Financial information can be complex and difficult to verify. Appraisals of non-residential real estate can be very complex, and their reliability may be difficult to establish. Additional security property and additional borrowers with a strong financial position may be necessary to make such loans work.

Recommendations

Issue regulation requiring lenders to establish written policies and procedures for loan operations (in addition to those covered in previous regulations); such documents should cover all loan types authorized by board of directors and provide sufficient guidelines for employees and officers responsible.

Generally, most lending secured by commercial properties should be discouraged or even prohibited in the early stages of establishing this mortgage market, due to risk, size and complexity, and complicating issues in market still unresolved.

Insider transactions

One of the greatest risk factors for financial institutions is abuse by insiders, including owners, directors, managers, and affiliated entities. Usually most such abuses occur in depository institutions, because outside funds are cheap, easy to obtain, and often government-insured. This risk is reduced substantially with mortgage finance corporations as envisioned by the Law and Regulations. Nevertheless, some risks remain, because of accessibility to borrowed funds and for other reasons. For instance, one investor might take advantage of access to loans at favorable terms, to the detriment of other investors. Such transactions can be concealed through related entities.

Recommendation

Issue regulation prohibiting insider transactions, with some minor exceptions.

Provisions of the regulation should include:

- Definitions of close relationships governed – Any owner, officer, director, or employee of the lender, including any affiliate and family relationship; business affiliation includes mutual ownership across all entities owned by lender owners above a certain threshold (usually 10%); family relationship defined to particular degree typical for such laws.
- Lending limitations – General prohibition of close relations receiving loans; may make exceptions for managers and employees for home loans or home improvement loans, if terms and conditions are no more favorable than for market loans.

- Loans for stock investment in this company should be prohibited; other loans made to investors should be scrutinized to ensure they are not a concealed version of this type transaction; also exchange-of-loans type of arrangements with other lenders for the purpose of circumventing this provision should also be prohibited.
- Sales of Real Estate Owned (REO) through foreclosure – Persons with close relations should be prohibited from purchase of REO, or from other benefit, such as sale commission or appraisal fee.
- Other services – Due to potential conflicts of interest, close relations should not perform ancillary lender services, such as appraisals, real estate brokerage, or loan brokerage.

Licensing

Effective performance of this function is critical in limiting entry to the marketplace only to strong, ethical, and beneficial lending organizations. Prevention is the best cure. This area includes licensing of other major lender operations, including opening branch offices, change of control, stock issues, debt issue, major products and services.

Part V, Articles 27 to 37 of the Regulations give requirements for licensing of real estate lenders. Article 27 addresses founding issues. Article 28 sets out application requirements, including application form, founders and founding documents, qualifications of directors and officers, no bankruptcy and no criminal record of founders and directors, two auditors' opinions, and receipt of fees. Article 29 addresses application fees. Articles 30 to 34 deal with further requirements and procedures for granting license. Article 35 gives operating requirements including compliance with Egyptian accounting and auditing standards, 10% capital-to-assets ratio, 25% ratio of current assets to current liabilities, loans not to exceed ten times capital, and establishing rules for good and proper process of work. Articles 36 and 37 give application requirements for orderly discontinuation, liquidation, or merger.

Overall, these provisions address most important issues relating to *initial* real estate finance company formation and market entry, as well as some later changes (Article 36). Some further provisions are considered warranted, however, including an initial business plan and budget, office premises information, and any market research in support of their entry into the market.

Also, under Law and Regulations, MFA is responsible for licensing supporting professions including appraisers, real estate brokers, and loan brokers (Articles 38 to 43 of Regulations). Proposed regulations for licensing and duties of agents-in-foreclosure are reported to being developed. Though duties of appraisers (Articles 42 to 48 of Regulations) and loan brokers (Articles 49 to 52) are set out, none are set out for real estate brokers.

Recommendations

Issue regulation revising application procedures for lenders wishing to enter market.

Materials presented should include:

- Standardized application form - Identification of founders and their contributions; resumes of business and professional experience, financial statements
- Certifications from law enforcement authorities showing no criminal record

- Initial business plan and budget – Should include loan types, estimates of loan volume and growth, funding sources, other relevant financial estimates, including forecast income and expenses
- Location(s) of office(s); sizes and descriptions of premises
- Any reports of research into real estate market to be served and loan demand
- Other documents considered necessary for supporting license approval

Issue regulations for licensing of changes in other major lender operations, including opening branch offices, change of control, stock issues, debt issue, major products and services. Such regulations or memoranda should set out application form, identification of activity or change being applied for, support documentation.

Revise regulations for licensing support professionals real estate appraisers, real estate brokers, and real estate finance brokers to include credit or requirements (additional or offsetting) for education and professional training. Continuing professional education credits should be required annually or biennially for license retention. Proposed agent-in-foreclosure regulation has model requirements for license granting, renewal, and revocations that would be useful. Some accordance among these requirements should exist across these professions.

Management and corporate governance

This area is critical to the safe and sound operation of lending organizations, though it is difficult to write regulations that are specific about relevant areas. MFA can supervise this area most effectively by requiring adequate written policies and procedures, which should always be approved by the board of directors and reviewed periodically for relevance and effectiveness. Several specific recommendations have already been made, particularly in the lending areas.

The board of directors is ultimately responsible for corporate governance over all activities of the organization, which is mainly accomplished with effective policies and procedures and monitoring of operations for compliance. Effective management includes establishment and implementation of adequate accounting systems, internal control, internal and external audit, business plan and budget, and policies and procedures for all major operational areas. Two external audits reports are at present required under Article 33 of the Law.

Recommendations

Issue regulations requiring written policies and procedures in major operational areas. Memoranda or other less formal communications with lenders can address more specific guidelines and concerns, such as for external audit standards. Models for these activities exist in most regulatory sources. Mortgage finance company policies and systems should include:

- Accounting systems which provide an adequate record of lender business transactions and which provide accurate and reliable reports for management to base decisions on; system operations should conform to international accounting standards (IAS).
- Internal control, which includes organizational structure, systems and functions, authorities and responsibilities which are intended to reduce risk by monitoring ongoing activities, and which find and correct weaknesses and errors; internal control processes and activities should be pervasive throughout business operations; evaluation of internal control systems is an integral part of external audit and regulatory examinations.

- Internal audit, which is an organizational function which reviews risk areas on an ongoing basis, usually using sampling techniques on transactions and other activities, regularly and promptly reporting its findings to management; the internal auditor should report directly to the board of directors.
- External audit on at least an annual basis, by a qualified independent audit and accounting firm according to international auditing standards; audit report, including opinion on financial statements and internal control comments should be provided to MFA, whose personnel should have close contact with auditor to discuss all relevant issues. Two-auditor requirement under the Law should be dropped.
- Business plan and budget should be developed and revised at least annually; business plan should set reasonable goals, assess internal organization strengths and weaknesses and external opportunities and threats; a budget will estimate income and expense for business operations toward these goals; organization operating results should be monitored on an ongoing basis and compared with business plan and budget.

Financial performance

The mortgage lender's financial performance should be managed according to its business plan, budget, and other projections and forecasts. In addition the lender should be able to react to market contingencies. MFA must assess that the lender's financial performance is strong enough to ensure safe and sound operation that does not take on undue risk. Profitable operations also support a strong capital position. Areas to evaluate include growth, earnings, liquidity and funds management, and asset-liability management and rate sensitivity. MFA will monitor lenders' financial performance through review and analysis of a system of regular prudential reports (off-site monitoring), external audit, and on-site examination by MFA inspectors.

Poor financial performance may be expected and even planned for during initial stages of entry into market.

Liquidity Ratio – Most model regulatory regimes are for depository institutions, which have the risk of liquidity insolvency through loss of deposit accounts. Mortgage lenders supervised by MFA will *not* have this risk exposure, though they will need to carefully plan for liquidity needs. At present Article 35 C of the Regulations apparently requires that current assets represent at least 25% of current liabilities, Current (circulating) assets are defined and liabilities are not defined. This approach does not take into account funds flow, timing of maturities or accessibility, and management, including short-term commitments, loan sales, and access to borrowings. Short-term cash needs and their timings should be balanced against cash available and how quickly particular liquid assets can be converted to cash with little or no loss. Annual external audit will include statement of sources and uses of funds; business plan should forecast anticipated sources and uses of funds for coming year. Asset quality is also an issue for liquid investments.

Prudential reports. Financial statements are required every six months under Article 33 of the Law, according to criteria in Regulations. A system of reports are being developed at present. Periods for submission of each report (daily, weekly, monthly, quarterly, annually) should be according to need for information. Electronic submission should be encouraged or required. Such reports should be submitted on forms developed by MFA and should include at least the following:

- Statement of condition (balance sheet)

- Statement of operations (income)
- Commitments and other off-balance-sheet items
- Loan activity, including breakdown of types of loans, for loans and participations originated, sold, and purchased during the period (due to legal and market constraints, leases may be a method for lending on homes or consumer items; these should be reported also, though noted separately)
- Loan portfolio, including breakdown of loan (and lease) types
- Delinquencies, asset classification, loss reserves
- Loans and participations serviced for others
- Report on capital adequacy, including breakdown of capital showing classes of stock, paid-in capital, retained earnings, undivided profits, and any changes from previous period; report on risk-based assets used in capital ratio calculations.
- Liquid assets and compliance with liquidity regulations
- Borrowings and other debt, broken down by type and maturities

Recommendations

(See also recommendations pertaining to business plan, budget, and monitoring under Management and Corporate Governance; also note recommendations on external audit.)

Continue with development of prudential report forms and procedures, with view toward minimum regime of those reports previously listed. Information obtained should be complete, correct, and useful to meaningful analysis. Avoid requiring excessive and burdensome reports. Reports and report forms should not be revised too often, so that longitudinal information can be accumulated.

Issue revised liquidity regulation, more comprehensive, flexible, and tailored to needs of market. Some provisions to be considered include:

- Requirement for cash on hand or in immediately accessible deposits sufficient for current needs.
- Definition of current assets – Cash on hand and in financial institutions (immediately accessible accounts) and financial institution deposits and other qualifying investments maturing within six months.
- Definition of current liabilities – Commitments, other off-balance-sheet items, debt and other obligations maturing within six months.
- Current ratio calculation, with supporting data, should be reported weekly.
- Alternatively, lender can develop liquidity policies and procedures approved by its board and acceptable to MFA. Such policies should provide for a regularly revised sources and uses of funds statement. Reports demonstrating compliance should be submitted at least monthly.

Issue regulation limiting qualifying liquid investments to “safe” government notes or bonds or commercial instruments with high rating by recognized international rating firms (such as Moody’s, Standard and Poor, Value Line). CBE liquid investment regulations should provide a good model for investment quality.

Consumer protection

This area includes the subjects of disclosure requirements for lenders and predatory lending practices.

Public education and disclosures. With little tradition of conventional mortgage lending, neither the public, nor even such informed sources as the press, have a good understanding of the benefits and responsibilities of mortgage lending. The general public may have some unrealistic expectations due to misinformation from official or other respected sources themselves not adequately informed. Lenders interviewed stated this was an ongoing challenge, and most were addressing it through mass communication, point-of-sale documents, and oral communications during the application process. The EFS project is also addressing this area through outreach. Truth-in-lending type disclosures in law and regulation will also be developed. All these steps can help over time. But this will remain an important area, as the borrowers and buyers must understand financing for the market to work.

Disclosures made from lender to applicant should occur before, at, and after closing. At first contact, customer should be given brochure describing responsibilities and risks of home ownership and of mortgage loans secured by real estate. *Before closing.* When the customer makes application, he should additionally receive a pro forma settlement statement showing typical closing costs, and a preliminary annual percentage rate disclosure statement. These disclosures will be for this anticipated transaction and should include admonitions that the amounts are only estimates for the purpose of illustration.

At closing, borrower should receive settlement statement of all costs and showing sources and applications of all funds; borrower should also receive a disclosure of his loan's annual percentage rate. Guidelines for calculation of such disclosures should be disseminated by MFA in memoranda. In all cases, borrowers should sign document acknowledging receipt of disclosures; copies of disclosures should be kept in loan file.

After closing, borrower should receive statements, at least annually, of loan payments made, principal and interest, and of remaining loan balance. Also included should be any changes in loan terms, such as interest rate changes if loan is adjustable rate mortgage. Notices of delinquency or other borrower non-performance should be timely and clear (and well-documented) in order that the borrower may take corrective action. Advertising of mortgage rates should include all terms affecting cost of credit and estimate of annual percentage rate.

Recommendations

Issue regulations requiring disclosures set out preceding from lender to customer before, at, and after closing. Advertising should meet requirements shown also. These disclosures should only be required on loans for purchase, construction, or improvement of borrower/owner-occupied housing, not loans on rental or commercial real estate or for speculative construction. Regulations, and follow-up memoranda, should include model forms for disclosure. Memoranda may need to be issued to cover instances of calculation of annual percentage rate, which may in some instances be quite complicated. Lenders may use their own forms if adequate for compliance. MFA should review settlement statements and other disclosure forms used by lenders to determine their adequacy.

Predatory lending practices occur when lenders take advantage of unsophisticated or distressed borrowers to obtain excessive interest rates or to acquire the security property by unethical means. Such practices are characterized by lacking, incorrect, or misleading disclosures of true credit terms. For instance, often low introductory rates are increased substantially later; or the period of the loan term can be accelerated by the lender; or up-front loan fees are excessive; or there exist other

hidden fees and “service charges” not disclosed earlier or unclear. These practices are difficult to regulate because they are difficult to define and in many cases may be technically legal. It is therefore also important that MFA not discourage legitimate lending, loan servicing, and collections practices.

Recommendations

The recommended regulatory strategy for these practices will require careful judgment by regulators, education of lenders, and aggressive enforcement of consumer disclosures, which can help prevent such practices.

Issue regulation prohibiting predatory lending. Definition should include lending:

- Directed toward customers who are financially unsophisticated and/or normally unqualified for this type loan;
- Whose rate and/or other terms and conditions are much more severe than market rates;
- Whose disclosures of credit costs and loan terms are missing or intentionally obscured;
- Where security property is main or only component of loan underwriting.

Regulation should contain statement that it is not intended to impair legitimate loan underwriting, servicing, or collections efforts.

Memoranda should be issued from time to time by MFA describing cases of predatory lending, whether from the Egyptian market or elsewhere (lessons learned).

Related entities

Mortgage finance companies may be owned by holding companies and other parents, such as banks. Mortgage finance companies may create or invest in subsidiaries and affiliates to serve some business need. MFA should have authority to examine the business operations of all related entities in order to assess their risk exposure for the lending company. For entities that are adequately supervised by other regulatory authorities, such as the Central Bank of Egypt, MFA should establish cooperation with a memorandum of understanding or similar document. In such instances, MFA may receive adequate regulatory information from other sources, so that it need not perform, for instance, comprehensive on-site examination.

Recommendations

Issue regulations empowering MFA to inspect, regulate, and require reports from related entities, such as holding companies, subsidiaries, and affiliates. A provision should address cooperation with existing regulatory bodies such as the Central Bank.

Anti-money laundering and Combating Financing of Terrorism (AML/CFT)

AML/CFT has emerged as a serious issue for financial institutions and can expose them to material reputational and operational risk. Since MFA-regulated lenders will not themselves have deposit accounts or transfer operations, these risk factors for money-laundering or financing of terrorism can be significantly reduced. Real estate lenders may, however, have exposure in relationships with parent or affiliate banks or through bank accounts and similar transfers. Also, loans and other disbursements may tend to be in large amount and volume, and could serve as a tool for money-laundering or financing of terrorism.

Recommendations

Issue regulations relating to AML/CFT which are compatible with Egyptian law on these subjects. Money-laundering and financing of terrorism should be prohibited for real estate lenders. Lenders should be required to establish board-approved policies and procedures to prevent these activities. Lender's internal control system and internal audit function should monitor operations to disclose such prohibited activities. MFA should become an active participant in any existing AML/CFT committee with lenders and regulators to address issues. Memoranda may be issued from time to time to lenders by MFA to clarify issues. Guidelines for such regulations and activities are available through various international organizations.

Supervisory actions

Just as other regulators, MFA needs a system of increasingly severe actions for ensuring that real estate lenders are brought into compliance with regulations and operate in a safe and sound manner. On-site examinations, off-site monitoring, external audits, and ongoing internal audit procedures can all find and report problems of all sizes and complexities. Lender management should respond to criticisms timely and should immediately correct errors and deficiencies that can be, or establish a plan for correcting larger more difficult problems. The supervisor and the lending organization should develop a relationship wherein ongoing supervision accomplishes goals beneficial to both. More stringent actions can be invoked for more serious deficiencies, in instances where management is not responsive, and where institution viability is impaired or threatened. Such actions can include fines and sanctions, and in more extreme instances, management removal; license revocation; closing, merger, consolidation, sale, liquidation.

Enforcement and prompt corrective action – Money penalties and *prison sentences* are set out in Part VII, Articles 45 to 52 of the Law, and can be charged to individual officer responsible for violation. Article 42 of the Law authorizes MFA to issue warning notice of violation and to require temporary suspension of activities. Criteria given are violations of law or regulations, as well as danger to stability of real estate activity or to the interests of investors.

Merger, discontinuation, liquidation – Article 42 of the Law also authorizes MFA to take various more serious measures against offending lenders, including merger and requiring additional capital. No provisions exist for removal of management or liquidation or even cessation of activities.

Enforcement powers as now written appear to have adequate stringency and to allow sufficient latitude in judgment of MFA. Specifics need to be tested, and whether a court will uphold such actions is unclear also.

Recommendations

MFA counsel should review Law to see whether regulations need to be added in accordance with Law or whether Law by itself is adequate. (See also Appendix A) MFA counsel should review Law to determine whether it possible or advisable to revise Law to include removal of management, license revocation, and closing and liquidation of institution.

Priorities and Action Plan

These tasks recommended for MFA will probably be performed by the Legislation and Regulation Department, with contributions and/or consultations with Legal Affairs and General Counsel and supervisory managers. Some tasks will require some further review of existing Law and Regulations and researching of other sources for model or example regulations. Some time must also be allowed for regulations to be drafted, enacted, or revised. MFA should generally review all these recommendations, which focus on regulations, to see if they are acceptable and whether revision of Law is necessary. Also, it is highly recommended that MFA work closely with professionals in EFS, who have expertise in “best practices” and who have access to resource materials. These initial regulations could be drafted by a working group of assigned regulatory personnel from relevant functions and departments, and chaired by a senior officer or internal advisor of MFA. Experience in other emerging markets indicates the Law(s) for regulating banks or other financial institutions may take several successive revisions over months or years to deal with various emergent issues. In addition, with this volume of proposed regulations and revisions, some time will be needed to accomplish most of them, even though many could be accomplished quickly by themselves.

The final step for each recommendation is approval and adoption by the MFA Board of Directors.

It is also recommended that proposed regulations and revisions, once drafted, be submitted to regulated mortgage lenders and other relevant stakeholders for their comments.

A number of other market and legal issues need to be resolved as preconditions for this regulatory regime to be effective.

Time frames are given by quarters beginning 2006.

Difficulty to accomplish tasks may be expressed in estimated time and in personnel and other resources necessary. Obstacles (interim conditions or priorities), and complexity, such as number of stakeholders who have to agree, will also affect difficulty.

Most items are initiated in one quarter and completed in the next quarter. This allows some flexibility in scheduling and allotment of time and other resources. Priorities will likely change from time to time with shifts in the market and resolution (or not) of obstacles.

Immediate or in process and ongoing

Prudential reports - Continue with development and issuance; roughly, the following order of development is suggested:

- Statement of condition (balance sheet) and Statement of operations (income)
- Loan activity, including breakdown of types of loans, for loans and participations originated, sold, and purchased during the period (due to legal and market constraints, leases may be a method for lending on homes or consumer items; these should be reported also, though noted separately)
- Commitments and other off-balance-sheet items
- Loan portfolio, including breakdown of loan (and lease) types
- Delinquencies, asset classification, loss reserves
- Report on capital adequacy, including breakdown of capital showing classes of stock, paid-in capital, retained earnings, undivided profits, and any changes

from previous period; report on risk-based assets used in capital ratio calculations.

- Liquid assets and compliance with liquidity regulations
- Borrowings and other debt, broken down by type and maturities
- Loans and participations serviced for others

Central Bank of Egypt – Discussions on cooperation; initiate

MFA Job descriptions – Revise and complete

MFA Organization and functions – Review, revise, adopt

First Quarter 2006

Appendix A recommendations should be reviewed to determine whether the Law or Regulations should be revised to resolve incompatibilities.

Legal authority - Recommendations in the report body should be reviewed to determine whether MFA has authority to issue particular new or revised regulations. Revisions to the Law, granting MFA sufficient authority, should be proposed. These regulatory recommendations will be postponed until necessary laws or revisions are enacted.

Loan types authorized – Consider (perhaps temporary) prohibition on commercial loans (exceptions - small and to regular customers).

Lender written underwriting policies - Initiate

Minimum credit underwriting standards - Initiate

Licensing of new institutions - Initiate

Major operational areas, lender policy (accounting and reporting systems, internal control, internal and external audit, business plan, budget) - Initiate

Related entities - Initiate

Anti-money laundering/combating financing of terrorism - Initiate

Second Quarter 2006

Lender written underwriting policies – Complete

Minimum credit underwriting standards - Complete

Minimum loan file documentation - Initiate

Insider transactions - Initiate

Licensing of new institutions – Complete

Major operational areas, lender policy (accounting and reporting systems, internal control, internal and external audit, business plan, budget) – Complete

Licensing of changes in major lender operations - Initiate

Supervisory actions (MFA counsel should review law to determine whether it possible or advisable to revise Law to include removal of management, license revocation, and closing and liquidation of institution.) – Initiate and complete

Consumer disclosures - Initiate

Predatory lending - Initiate

Related Entities - Complete

Anti-money laundering/combating financing of terrorism - Complete

Third Quarter 2006

Minimum loan file documentation - Complete

Insider transactions – Complete

Asset classification and loss reserves - Initiate

Lender policies for non-performing loans - Initiate

Licensing of changes in major lender operations – Complete

Licensing of support professionals – Initiate (revision and extension of existing)

Liquid investments permissible - Initiate

Loan types authorized – Initiate and complete

Internal control (memorandum) – Initiate and complete

Consumer disclosures - Complete

Predatory lending - Complete

Fourth Quarter 2006

Asset classification and loss reserves - Complete

Lender policies for non-performing loans – Complete

Other loan operations, lender policies (for loan types and matters not covered in other required policies) – Initiate and complete

Licensing of support professionals – Complete

Internal audit (memorandum) – Initiate and complete

External audit (memorandum) – Initiate and complete

Liquid investments permissible - Complete

Liquidity (more comprehensive and flexible version) - Initiate

Minimum residential appraisal standards - Initiate

Capital Adequacy (risk-based assets) - Initiate

Collections, foreclosure, loss recovery (revisions to existing) -Initiate

First half of 2007

Liquidity (more comprehensive and flexible version) - Complete

Minimum residential appraisal standards - Complete

Capital Adequacy (risk-based assets) - Complete

Collections, foreclosure, loss recovery (revisions to existing) - Complete

Appendix A

Comparison of Executive Statutes with Real Estate Finance Law

Law 148/2001: **Real Estate Finance Law** (Law)

December 8, 2001 – Cabinet of Ministers – **Executive Statutes of the Real Estate Law** (Regulations)

To provide organization for this review, headings from below are from Real Estate Finance Law (Law), though discussion includes both Law and Executive Statutes (Regulations).

In the first part of each section is a summary of provision. These are intended only as reminders for convenience. Please refer to the text of the Law and Regulations for particulars. Original documents in Arabic language are controlling. Comments and Recommendations follow in each sub-section.

Part- I: General Provisions

General: No general discussion of regulations and purpose of MFA. (Fraud Decree)
[General question: Should regulations/statute include Law or reference to law, or nothing of law?]

Definition of mortgage lending: (Article 1 of Law and Articles 1 and 2 of Regulations)
Purposes of loans and property types on which loans can be made. Regulations generally follow the Law. These definitions essentially set out powers of mortgage companies in purpose and property types. Article 2 of Regulations goes further to set out conditions for additional borrowers or guarantors.

Comment:

Regulations contain no simple declaration that such loans are to be secured by a first mortgage on the real estate. Article 2 of Regulations contains useful provisions for additional borrower or guarantor.

No provision for refinance, i.e., loans secured by homes already owned and occupied.

Commercial properties (“buildings of store”) included. Not clearly defined. Could open to broad powers in commercial real estate lending with no limitation on quantity and few controls.

Other relevant issues, outside these documents, include difficulty of registering clear title, obtaining chain of title, and of accurate appraisals due to lack of reliable comparable sales or rental data.

Recommendations:

Add language to regulations clarifying loan security as first mortgage. This could be an extension or elaboration of paragraph 2 of Article 1 of Law.

Review refinance as a possible power. A big benefit would be to allow home owners to liquefy their ownership interest, i.e. take out cash against asset for certain worthwhile purposes. Adequate consumer disclosure of risk necessary. One serious current obstacle to refinances is sound appraisal report, which is critical when subject property has no sale price as evidence of value.

Formation and Empowerment of Mortgage Finance Authority (MFA): (Article 2 of Law)

Authorization of mortgage lending companies and of mortgage lending powers: (Article 3 of Law)

Comment:

No regulatory language exists

Recommendation:

MFA general counsel should, with EFS counsel consultation, review these and other portions of the Law to determine whether Regulations should be issued to conform to these items.

Empowerment of regulations: (Article 4 of Law)

Lending activity according to regulations; some specifics given.

Regulations set out some specifics: (Article 3 of Regulations)

- Disclosures of procedures and finance agreement

- Loan-to-value ratio cannot exceed 90 percent

- Value determined by appraisal (no conflicts of interest)

- No more than 10% of lender equity to be lent borrower or relatives or affiliates

- Borrower income verified by tax authority or employer

- Payment not to exceed 40% of borrower income

Comments:

Regulatory provisions seem to be in accordance with powers permitted by Law.

Language and provisions themselves are basic.

Language on 10%-of-equity rule is unclear; reference at end of paragraph about capital contribution to juridical persons.

Appraisal results are for now of limited reliability due to difficulty verifying comparable property sales.

Recommendations:

Language on appraisals, e.g., meeting acceptable professional standards (including date, appraiser name, three approaches, sound data and methods, final correlation).

Separate paragraph on appraiser qualifications, lender approval of appraiser, no conflicts of interest for appraiser chosen for particular property.

Value definition to include cost and sale price (these not always available) as well as appraisal value estimate, and defining as lowest of three methods.

Economy-level housing for low-income borrowers: (Article 5 of Law)

State-provided land and half-cost utilities

Some particulars of execution (Articles 4, 5, 6 of Regulations)

- Developer application; agreement with Fund

- How fund is to handle land, utilities cost, and funds.

Comments:

Some references to other laws. Not detailed instructions.

Recommendations:

None yet.

Part- II: Finance Agreement

Law sets out several conditions pertaining to transfers (Articles 6, 7, 8, and 9 of Law)
Finance Agreement among lender, buyer/borrower, and seller; specifics
Sale or lease requires approval of lender; borrower can continue liable; lender cannot refuse except for “serious reasons”
If violation, lender can accelerate payment
Borrower may accelerate (or pay off) loan; payoff amount reduced

Disposal, leasing, settlement (Articles 7, 8, 9, 10, and 11 of Regulations)
Disposal, lease, or third-party occupant; application more than 30 days
Assumptor declaration attached to application: lender can require borrower continuation
Lender can require an assignment of rents declaration
Lender cannot refuse except for “serious reasons”; must notify within 30 days of rejection, else automatic approval
If borrower wishes to accelerate payments, must notify no less than three months; table for calculation of payments

Comments:

Regulations generally follow law, adding a few specifics. Language appears to vary. Rental of property (change of use) or change in occupants (except family) are risk factors; lender should underwrite any such change and be able to refuse for any reason, unless original loan agreement addresses procedures for these instances.

Recommendations:

Delete lender refusal provision and deadline
Change wording of Article 7 of Law and Article 10 of Regulations; NO advance notice of prepayments required; any advance payments will be applied first to any interest and fees accrued, and the remainder to principal. Model lending agreement can address such conditions in advance.

Part- III: Registration of the Real Estate Security and Transference of Rights Resulting From the Finance Agreement

Registration of security property: (Article 10 of Law and Articles 12 and 13 of Regulations)
Application submission requirements set out; decision within one week; assignee quarter to settle rights; notification of applicant of approval or denial. Regulation sets out documents to be included in filing and registration office duties in handling the application.

Comments:

The Regulations generally follow the Law, with some additions, such as deadline requirements.
Many potential title and registration issues not dealt with here, but under a different part of the project.
Language allows borrower to file security document. Such procedure would be a serious risk for the lender.
Language includes “not” which seems to negate the intent. Translation?
Law requires certain action of registration authority. Does it have authority over registrar? (supercession)

Law – 3rd paragraph, “assignee quarter” language difficult to understand.
Translation?

Recommendations:

Law and Regulations should delete reference to borrower/ investor filing of documents. Filing could be allowed by lender’s designee third party, such as title company or loan closing agent.

Translator and MFA counsel should review language where noted to see whether clarification is warranted.

Secondary market sales: (Article 11 of Law and Articles 14, 15, and 16 of Regulations)

Transfer agreement

Third party guarantors of securities

Lender’s disclosures about borrower/loan to transferee

Comments:

Subject to (and in conformity with) Capital Markets Law 95/1992, et al.

Law mentions lender as servicer/ executor of loan agreement and duties; not in Regulation, but mentioned in provisions to secondary market agreement.

Recommendations:

None at this time

Part - IV: Execution on the Realty

Defines procedure to acquire/ sell security property due to borrower default. (Articles 12-27 of Law and Articles 17-26 of Regulations) Include (Regulations):

Notice and Demand to borrower

Add forced sale “formula” [legal wording] to agreement and notify all parties (“enunciate”)

Notice to Real Estate Registration Office (notes on filed copy); notice to other creditors

Annotating writ of execution; expropriation caveat; realty under attachment

Magistrate appoints real estate agent (deadline and dates unclear);

magistrate directs lender to deposit for-sale expenses

Two valuation experts provide basic price; some guidelines given

Real estate agent within 15 days of “formula” issues statement of conditions for auction sale; detailed procedures given; bid bond set at 1-5% of basic price

Real estate agent ensures announcement (publication?) of conditions et al.

Real estate agent deposits sale proceeds to treasury of court within 3 days of sale

Real estate agent fees determined by magistrate, not to exceed 3% sale price

Comments:

This section of both Law and Regulations is quite thorough and detailed in prescribing procedures.

Generally, regulations follow the law, but do not contain all provisions.

Regulations begin with notice of sale, with no discussion of default as reason or reference to Articles 12 (default and warning) and 13 (warning lapses and magistrate request) of Law

Notices to borrower, appointment of real estate agent, proxies set out in Articles 14-16 of Law; definition of proxies not clear (probably intermediaries)
Regulations do not address Article 17 of Law, replacement of proxies at request; could be capriciously approved by magistrate
Pricing at sale. Article 18 of Law (and Article 22 of Regulations) directs that two appraisers shall determine basic price of property, but is unclear about how. Do two appraisers perform provide one joint report, or two separate? How is it settled if they disagree?
Article 20 of Law protects lender, includes provision for lender purchase if price is less than due to lender. *But* must release borrower if accepts sale.
Article 21 of Law seems to allow borrower to stop all action by bringing the loan current. This may include late fees and penalties and acceleration of the debt (all due).
Provisions and actions of Articles 22, 23, 24, 25 of Law (adjudication, registration, appeal, and third party action) not included in Regulations.
Article 26 of Law on disposition of foreclosed property sale proceeds does not state whether remainder, if any, is to be paid to borrower. Text could be clearer that first lien holder is to receive complete amount due before next lien holder receives any of its, and so forth through the hierarchy.

Article 23 of Regulations – Method of publication of sale conditions not clear

Law provides that property must be sold at appraised value, which is full market value, despite auction method, which usually results in lower price. Lender only allowed to bid if sale has failed.

Regulations contain no discussion of sale itself—how executed.
Affect of bankruptcy law is unclear, as is how borrower bankruptcy would affect the process.

Recommendations:

Law (Article 20) (and Regulations) should allow for deficiency judgment, if security property is not sufficient to satisfy debt.
Provisions of Article 20 of the Law (auction performance) should be included in Article 24 of the Regulations.
Provisions of Article 21 of the Law (borrower satisfies delinquency and reinstates loan, at any time) should be included in Regulations. Inclusion of accumulated lender late fees, penalties, acceleration, and court costs could be clarified in Regulations. Note: acceleration provision in loan agreement would prevent reinstatement of serious delinquency.
Provisions of Articles 22, 23, 24, 25 of Law should be incorporated by reference into Regulations, perhaps as insertion into Article 25 of Regulations.

Article 25 of Regulations contains part of Article 26 of Law; remainder should be included at least by reference.

Regulations should include provision that lender and borrower may at any time by mutual agreement negotiate a settlement, which will stop and resolve adjudication. Note: The court, however, cannot itself decide and enforce (say on petition of borrower) such a settlement outside the provisions of the Law and Regulations and the terms of the original loan agreement.

Review for clarification of how bankruptcy law and procedures would affect this process. Some language may need to be added to Law and/or Regulations.

Part V - Real Estate Finance Companies

Founding capital (Article 28 of Law and Article 27 of Regulations) set at LE 50 million, with one-quarter at founding and remainder within one year.

Licensing application form and data (Article 29 of Law and Articles 28 and 29 of Regulations); Regulations reference form (not shown) and list data requirements; fees.

Receipt for documents received, notification of other documents required (3 mo. deadline) (Article 30 of Law and paragraph 1 of Article 31 of Regulations)

Permitted grounds for refusal of application (Article 31 of Law and Article 30 of Regulations)

Approval and notification of decision (paragraph 2, Articles 31, 32, 33 of Regulations)

Financial criteria to be defined (Article 32 of Law and Article 35 of Regulations); Regulations set out:

- Use of Egyptian Accounting and Auditing Standards

- Capital ratio of 10% of assets

- “Circulating” [Current?] assets cannot exceed Circulating Liabilities by more than 25%

- Total loan limit at 10x capital

- “Rules for...process of work”

Auditors and audit reports (6 month intervals) (Article 33 of Law and Article 34 of Regulations)

Change in company status: Merger, discontinuation, liquidation of assets (Article 34 of Law and Article 36, 37 of Regulations)

Comments:

Licensing application requires statements by key persons about character, crimes, and bankruptcy, but no third party confirmation.

MFA can only reject application if certain criteria fail. No business plan and budget requirement.

Two auditors required for licensing (Article 29 of Law and Article 28 of Regulations) and also ongoing reporting (Article 33 of Law and Article 34 of Regulation). Why two and why any at this licensing/ founding stage with little or no activity? Can capital be verified in another way?

Financial reporting to MFA to be done only by audited (or auditor-approved) financial statements?

Financial criteria:

Capital ratio simple; regulatory capital not defined; ratio calculated to assets denominator, though significant risk may be off-balance-sheet.

“Circulating” ratio unclear; Law says minimum ratio to be given, but Regulation seems to give maximum ratio.

Total loans ratio (apparently to answer Law “volume of finance portfolio”) seems superfluous, since it (10x capital) matches 10% capital ratio for total assets. (If capital ratio met, lending ratio would always be met, arithmetically.) No limitations on

types of lending, especially those with greater risk by purpose (construction, development) or security property type (buildings of store).

Merger, discontinuation, liquidation: Law restricts MFA ability to refuse, puts burden of proof on MFA not mortgage company. Liquidation could be loan sale in normal course of business.

Recommendations:

General on capital: Article 27 of Regulations should state that capital requirement at any time [including during first year] is the greater of that required by this article and that required by capital ratio article (Article 35 B of Regulations).

Applicant criteria: Article 28 of Regulations should reflect third-party confirmations (from police, other law enforcement, courts, regulatory authority, professional organizations, and creditors) of significant character warranties and statements.

Application action: Revise Law (Article 31) and Regulations (Article 30) to provide more flexibility to regulator to reject applications; burden of proof should be on applicant (other provisions for requirements do support this somewhat).

Financial criteria

Liquidity ratio: Regulation should define liquid assets; liquidity base (denominator) should include commitments and off-balance-sheet items that are to funded. Law would need to be revised because it defines denominator as current liabilities (under Egyptian accounting and auditing rules).

Loan limitations: Overall loan portfolio size will be limited by liquidity and capital ratios. Percentage limitations should be enacted for other than standard safe loans (defined as secured by first mortgage on single-family owner-occupied home with 80% or less loan-to-value ratio with regular monthly payments of principal and interest, and meeting regulatory borrower and appraisal underwriting requirements); these will include construction, development, land, or commercial property loans; also include non-conforming first mortgage loans for purchase or improvements.

Capital ratio: Capital account should be defined in greater detail, with core (regulatory) capital including permanent investment with non-cumulative or required dividends. In addition to 10%-of-assets requirement, capital requirement should be calculated as percentages of various categories of risk-based assets, including commitments, derivatives, and other off-balance-sheet items, and loans serviced. This is because of additional risk of loss in off-balance-sheet and non-asset items.

“Rules necessary for ensuring good and proper process of work”: Article 35 paragraph E of Regulations reflects Article 32 paragraph 4 of Law mostly literally. This regulation could be expanded at least somewhat to require *policies and procedures and a business plan and budge*, for both licensing and for ongoing operations. Risk management criteria should be listed and addressed.

Asset classification and Loss provisioning and reserves – No provision in Law or Regulations; might be authorized/ required under accounting standards (especially for banks). Needs to be set out in this section of regulations.

Merger, discontinuation, liquidation:

MFA should be able to disapprove application, according to its own judgment, for any documented reason (i.e., must state reason for rejection); burden of proof should lie

with mortgage company. Nevertheless, MFA should not restrict or obstruct normal and prudent business decisions with adequate risk assessment.

Business plan and financial forecast showing expected results should be included on applications pertaining to major actions, according to judgment of MFA. For instance, discontinuation of a loan product of specific interest rate or terms would not normally require such documentation, but the discontinuation of a major type, such as construction loans which have been active, would. Sale of an asset less than 5.0% of total assets, such as a branch office, would not, but the sale of a home office or a large package of loans would.

Loan originations and loan sales in normal course of business would not require prior approval.

MFA may, from time to time, issue memoranda to mortgage companies defining or refining such criteria.

Financial forecasts for a proposed merger should be prepared or attested as correct and reasonable by the company's auditor. MFA may also require auditor's opinion on certain large proposed transactions.

Financial forecasts should be reasonable and well-supported, though it is understood that actual results may vary.

Part VI - Real Estate Finance Guarantees

Part VI of Law and Part VII of Regulations – Hereafter the structure of the Law and the Regulations diverges significantly

[What is incentive to lender to enter into low-income loans?]

Law (Articles 35-41):

Fund established to subsidize low-income housing finance by paying portion of payment amounts. Fund resources set out. Lender can require life/disability insurance (Regulations set rules and conditions). Only approved intermediaries can be used (Regulations set rules and conditions). Applications form to be given to borrower and signed. Lender to notify borrower monthly of status of loan (Regulations set out particulars). Complaint department to be set up for violations.

Regulations (Articles 53-61):

Applicant to submit application and attachments to Fund. Lender role not clear. Fund decision and dates; approval of how much support. Fund to pay up to three installments not met for “accidental reasons” [text or translation not clear]; limit of once per five years. Insurance evidence of claim and settlement. Particulars of monthly statement from lender to borrower set out. Set up of office for complaints, submission and handling. Access to fund /Authority information.

Comments:

Procedures unclear on how lender is incorporated into process—both application and servicing.

Relationship of MFA to fund not clear. Independence and conflicts not addressed.

Regulations not clear on limited handling of borrower default.
Insurance settlement: Regulations not clear on lender beneficial interest.

Recommendations:

Procedures for application and servicing must include lender as with typical loan applicant, as well as Fund. Best would probably be for applicant to go through lender which would handle application and documentation with Fund, and later servicing. Applicant and lender would understand from the first that this is a low-income loan application.

Insurance: Should stipulate on policy that lender and borrower are joint beneficiaries, with the lender to be paid in full first and remainder to borrower.

Part VII - Control

All of this part is in Law only.

To protect stability of finance activities, and interests of borrowers and lender stockholders, administrative quarter may serve notice of violation, suspend activity and resolve consequences, cause merger of offending lender, require additional capital or liquidity (Article 42).

"Interested parties" have access to administrative quarter information, subject to confidentiality rules (Article 43).

"Officers of administrative quarter" have powers of law officers and access to information (Article 44).

Comments:

These provisions are in Law but not in Regulations, except certain references to access to information.

Actions to be taken left to MFA.

Recommendations:

MFA general counsel, with EFS legal assistance, should review and consider whether this provision of Law needs Regulation for form. Should add regulation about fitting remedy to seriousness of violation. Could be too formulaic, or conversely too general. Should provide guidelines instead of rules.

Part VIII - Penalties

(Articles 45-52 in Law only)

These penalties are subject to other laws, penalties.

Unlicensed real estate lending activity (no prison limit)

Violations of lending limits (Article 4 of Law) and financial criteria (Article 32 of Law)

No approval for mergers, discontinuation, or sale of assets (clause i [assumed to be first sentence] in Article 34)

Court can additionally revoke (for not more than three years) violator's license to operate in profession

Request of "concerned" minister necessary for criminal action; compensation may be accepted as abatement

Officer of company may be liable to penalties if "premeditated breach" of duties or "enormous fault."

Company liable for employee actions

Comments:

No prison limit given for unlicensed real estate lending activity; could be abusive.

Not sure of definitions of some terms where specific meaning is important

Concerned minister

Criminal [Is this separate and more serious violation, as in U.S.?)

Officer of company – Does this include CEO, middle managers over specific division, and/or directors?

Breach of duties

Enormous fault

Recommendations (Law):

MFA counsel (and translator) should review preceding terms for possible clarification.

Put limit on prison for unlicensed activity.

Some more specific, calculable penalties could be given for, e.g., liquidity.

Define persons within lending company who may be personally liable and clear criteria for when this may happen.

Part VI of Regulations

Valuing Experts, Real Estate Agents, and Loan Brokers

Other Regulations – Intermediaries

(Articles 38-52 of Regulations only)

MFA to provide application form

Minimum criteria: 5 years experience; level of qualifications specified; no felony, nor misdemeanor on moral turpitude or trust, no bankruptcy (unless rehabilitated).

Decision within 15 days of application; refusal to be substantiated.

Applicant complaint within 60 days; committee review.

Appraiser requests from loan parties data for appraisal process

Appraiser sends report, within 30 days; uses methods from Article 22 of Regulations

Conflicts of interest: Relationships with owners; purchasing appraised property

Party objecting may appoint two other appraisers to reappraise property; must pay.

Board of Authority sets remuneration levels.

Real estate finance broker gives applicant form and disclosures.

Remuneration by negotiation, not to exceed that set by Authority's Board.

Remuneration only from lender.

Broker to maintain records and documents and discloses when applied to by loan parties or Authority.

Comments:

Legal authority for these provisions is unclear, since no reference seems to appear in Law.

Applicability of rehabilitation and what it is, is unclear.

Burden of proof for application refusal on Authority.

Confusing and ineffective procedure for resolving appraisal objection.

No requirements for real estate broker, except for licensing.

Recommendations:

Apprentice licensing and qualifications.

Real estate agent/broker provisions.

For non-residential real estate, brokerage and appraisals should require special qualifications and standards.

Appendix B

Background and research

Meetings held

Key interviews

Mr. Osama Saleh
Chairman, Mortgage Finance Authority

Mr. Alaa Hozayen
Industry Affairs Advisor, Mortgage Finance Authority

Ms. Magda Abd El Mawla, Eng.
Central Administration, Mortgage Finance Authority

Mr. Khaled Rasekh
President and CEO, ERA Real Estate – Middle East

Mr. Ahmed Haggag
Consultant, Mortgage Finance, Egyptian Arab Land Bank

Mr. Ashraf Salman
Deputy General Manager, Arab African International Bank
Board member, Mortgage Finance Authority

Mr. Mohamed El Dib
General Manager, Board Member, NSGB (National Societe Generale Bank)

Mr. Diaa Eldin Mohamed Aly A. Rab
Sub-Governor, Control and Supervision Division, Central Bank of Egypt

Ms. Hala Adel Bassiouni
Chief Executive Officer, Egyptian Housing Finance Company, S.A.E.

Also reviewed were minutes of previous meetings of EFS professionals with key industry personnel.

Appendix C

Useful sources for regulatory guidelines

Most major financial regulators and other related organizations have web-sites in English language. This appendix contains a listing of many major web-sites. A number of useful sources for researching “best practices” are thus readily accessible on the internet.

One problem is too much information. Several of these regulators operate in complex and highly developed financial institution markets. Most such are banks and other depository institutions. Much of this material may not be applicable for regulating the Egyptian mortgage market at this time.

Each regulator or other organization will have its own characteristics, and as a result their regulations will have varying applicability to MFA, Egypt. These are discussed following, along with recommendations for guidelines related to specific regulations.

Links from these sites can also be helpful in finding related and relevant organizations.

<http://ecfr.gpoaccess.gov>

Electronic Code of Federal Regulations (Title 12 – Banks and Banking) contains all (or nearly all) regulations pertaining to U.S. banking. Of especial interest is Chapter V – Office of Thrift Supervision, Department of the Treasury. Some of these regulations will be useful and applicable, and some will not.

www.ots.treas.gov

Office of Thrift Supervision (OTS) is the U.S. regulator of thrift institutions (savings associations) which are depository institutions specializing in residential lending. Many of their regulations related to real estate security property, appraisals, and similar subjects are thus quite applicable to MFA.

www.bis.org/index.htm

www.bis.org/cbanks.htm

Basel Committee on Bank Supervision (Basel), located at the Bank for International Settlements (BIS), Basel, Switzerland issues guidelines in various areas pertaining to the regulation of financial institutions in developed countries, including U.S., Europe, and Japan. Of special note are the 25 Core Principles for Bank Supervision and Guidelines for Capital Adequacy. A number of other papers provide opinions and insight into specific regulatory areas.

www.fba.ba

www.abrs.ba

Federation Banking Agency (FBA) and Banking Agency of Republika Srpska (BARS) are the bank regulators for Bosnia and Herzegovina. Due to the recent war and the governmental structure that resulted, the country has two separate bank supervision agencies not as yet under the Central Bank, though they cooperate closely and have essentially the same laws and regulations. Despite these differences from Egypt, these regulatory regimes have the advantage of being relatively new and for a developing and transitioning market. They are thus also simpler than for most

developed countries, though they have been based on Basel and U.S. standards. The writer of this report has worked extensively in Bosnia and is familiar with these laws and regulations.

Of particular applicability as example guidelines for MFA and Egypt are Decisions/Regulations pertaining to Bank Supervision, Capital Management, Credit Risk Management and Assets Classification, Risk Concentration Management, Banks' Lending Activities, Non-performing Clients, Operation with Related Persons, Activities to Prevent Money-laundering and Financing of Terrorism, Internal Control Function, Internal and External Audit Function, Economic-Financial Audit, and others.

www.fatf-gafi.org

Financial Action Task Force (FATF) is one of primary sources for information on anti-money-laundering and combating financing of terrorism (AML-CFT).

www.ffiec.gov

The Federal Financial Institutions Examination Council (FFIEC) promotes accord among regulations and procedures of various U.S. bank and other financial regulators.

www.occ.treas.gov

www.fdic.gov

www.frb.gov

Office of Controller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and Federal Reserve Board (FRB) are the three main U.S. bank regulators. Of these, OCC will probably have most relevant information.

www.ofheo.gov

www.freddiemac.com

www.fanniemae.com

Office of Federal Housing Enterprise Oversight (OFHEO) regulates the two primary secondary mortgage market companies FHLMC and FNMA. Though of some interest, this organization does not regulate primary mortgage lenders. FHLMC and FNMA have developed standards and forms for residential loans, including credit underwriting criteria.

www.mbaa.org

Mortgage Bankers' Association (MBA) is the U.S. trade organization for various types of mortgage lenders. Though not a regulatory body, MBA through its web-site provides discussions of various important mortgage issues.